

PAY AS YOU EARN – PROGRESS REPORT

Note for the Consultative & Steering Committees

Main issues for Committee

1. Main issues on which the Committee are invited to comment are:
 - a. a **revised timetable for the regulations** to meet comments at the meetings in May and subsequently (paragraph 10 onwards);
 - b. a **process to rewrite the regulations in line with guidance** (paragraph 13 onwards); and
 - c. **proposed handling of draft clauses for Bill 2** (paragraph 18 onwards).
2. There is also a summary of issues emerging from work in progress which is intended to give the Committee a flavour of points on which we shall be seeking views from users in due course (paragraph 23 and Annex A).

Background

3. The Committees discussed in May 2001¹ an initial paper on the scope of work on the Pay As You Earn legislation² which was then just started.
4. Two main points emerged from the discussion.
5. **First , the timetable for rewriting the regulations was difficult.** This was partly because of the amount of work involved. But there was beyond that a fundamental difficulty in revising the regulations on a timetable which did not fit with the annual issue of guidance to employers. Making new regulations in March 2003 after the income tax Bill received Royal Assent would leave a catch 22:
 - a. the regulations could not make even minor rewrite changes or change labels because the guidance (and some forms) would already have been issued to employers; and
 - b. the guidance issued to employers could not be changed because the regulations had not been made yet.

¹ SC(01)Minutes (27), CC(01)Minutes (31)

² SC(01)03, CC(01)03

6. The increasing use of CD ROMS and the Internet for guidance for employers will mitigate this by allowing guidance (or revised guidance) to be issued later. But we cannot yet count on it to remove all the mis-match in the timetables.

7. **Second, the regulations needed to be looked at with the guidance.** The regulations were directed at ordinary people far more than the capital allowances legislation and so needed to be looked at alongside the guidance. The guidance was important both to users and also quite possibly to the Courts if users argued they had relied on it.

8. The Steering Committee (with the benefit of the Consultative Committee's discussion) asked that the project director consider with other Inland Revenue directors what was achievable and report back to the Committee.

9. We have subsequently also had the benefit of further helpful comments on the practicalities of the timetable in the course of a discussion with some members of the CBI.

Timetable for the regulations

10. We have reviewed the timetable in the light of the comments in May and further work. We now propose to the alternative timetable raised by the Consultative Committee then:

- make the rewritten regulations in autumn 2003; and
- apply the rewritten regulations from 6 April 2004.

11. This meets all the key points so far identified:

- a. the regulations apply from the start of the new tax year; (In principle regulations might be brought into force part way through a year but in practice that would constrain us to use much the same words)
- b. the regulations can be made and laid on the basis of the rewritten legislation in the first income tax rewrite Bill. And we remove the risk to the regulations of that Bill not getting Royal Assent by 14 March 2003;
- c. the regulations will be made before the guidance for employer is finalised so they can be kept in step and feed off one another;
- d. guidance on the new regulations will be in employers' hands well before they come into effect;
- e. any pre-rewrite changes to the regulations (including any coming out of legislation in the Finance Bill in 2002) can be made before the final consultation on the rewritten regulations.

12. This timetable does mean that the PAYE regulations will need to be amended to take account of the income tax rewrite Bill for the year from 6 April 2003. We think that will be manageable:
- a. the Interpretation Act would provide continuity of the regulations for the rewrite of the vires: on past consolidations of the Taxes Acts there have been no changes to the regulations to update the references to the powers under which they were made
 - b. there will need to be some amendments to the regulations to deal with points such as references in the regulations to primary legislation and points of terminology (for example after the income tax Bill “Schedule E” will not mean anything). However work on such points will be going on for the Bill’s consequential amendments to other legislation in any event. The regulations are likely to add few if any new points.

Regulations and guidance

13. We intend to move the regulations and guidance forward together by comparing the regulations with the current guidance and flagging up mis-matches. This is very much part and parcel of our normal approach when re-writing any legislation.
14. Decisions on what to do about the mis-matches can then be made as we go along. That may be a decision to:
- a. rewrite the regulation in line with the guidance where for example it is a matter of terminology or clarification;
 - b. revise the guidance to make the law clearer;
 - c. change the law – by way of pre-rewrite regulations if it is a matter of substance. That will be very much an exception to the rule. But some such points may arise and be taken up – for example in changes to the regulations for other, policy reasons; or
 - d. use a mixture of the above.
15. We do not see this as a matter on which there can be a single answer.
16. And it will not be one-way traffic. As guidance is revised we shall look at it to see if there are changes which illuminate the regulations or – exceptionally – suggest that the regulations need to be changed to achieve what is wanted.
17. The key point is that the process converges in autumn 2003 with mutually consistent regulations and guidance.

Primary legislation

18. We have also been considering the handling of draft clauses on the primary PAYE legislation. In doing so we have had the benefit of some helpful comments from and discussions with interested people the details of the handling of future draft Bills. We report progress on that in a separate paper for the Committee (see CC[] & SC[]).

19. But two points on the PAYE legislation seem clear:

a. it would not be very helpful to users for us to publish an Exposure Draft with clauses for the Pay As You Earn legislation (mainly sections 203 to 206A of the Income and Corporation Taxes Act 1988) in the New Year which both

- coincided with the Budget and Finance Bill; and
- left us with too little time to give proper consideration to the responses before the draft Bill in June;

b. it would not be practicable for us to publish draft clauses sooner. We have yet to complete our research into the legislation. The drafter looking at both the primary legislation and the regulations will be re-locating to the United Kingdom over the next couple of months.

20. We propose to cope with this by making draft clauses available – direct to interested parties and on the Internet – as they emerge, with a commentary drawing attention to points of construction which have caused us to pause and, of course, to any proposed rewrite changes. But we shall not hold these back to make up a formal Exposure Draft within bound covers.

21. This will be very much in step with the approach discussed earlier this year. We can be flexible to fit in with individuals' preferences by sending material by e-mail, on paper or whatever; and taking comments in stages and/or in draft (without commitment to later views). And – crucially – it will not replace the formal consultation of the draft Bill to be published in June.

22. We do not put this forward as a model for all future draft clauses.. But we see it as the best way to manage the work and timetable for the PAYE legislation so as to make the best use of the time users are willing to give us by commenting on the drafts.

Work in progress

23. In order to illustrate the points which may arise about the regulations and guidance Annex A lists briefly issues we are currently looking at. They span a wide range:

a. some will be the subject of detailed commentary when we have draft regulations

- b. some will turn out to be non-issues as we understand the legislation and practice better
- c. some will be points we can clarify in the course of rewriting the regulations
- d. some will be points of policy for consideration by Revenue Policy colleagues and which may or may not lead to changes separate from the project's work.

24. We are not inviting views on the substance or merits of the detailed points in Annex A. We do hope it shows our approach.

Bush House
October 2001

ANNEX A

POINTS FROM CURRENT WORK ON PAYE LEGISLATION

Separate pay schemes (regulation 3)

A1. The current provisions contain a number of conditions that do not seem necessary. We are considering how to improve the flexibility of the legislation which enables employers to opt for several “PAYE schemes”.

Troncs (regulation 5)

A2. We are looking at how the current provisions can be better expressed (and also considering whether the provisions might possibly be better placed in the primary legislation along with others which deal with who is responsible for operating PAYE).

A3. Currently the provision refers to “the organised arrangement commonly known as a tronc”. But it is questionable whether the term “tronc” is used as widely as it may have been when the provision was first introduced.

A4. We had considered dropping the term “tronc master” for similar reasons, but there seems to be no good alternative label to use. We shall however ask users (for example those in the trade).

Coding (regulation 7)

A5. We are looking at ways of clarifying the legislation that governs the determination of a code to bring out things like the coding out of underpayments and of income not assessable under Schedule E.

A6. We also think it preferable to have a clear statement of all the special codes (i.e. those that are neither suffix codes or K-codes) and when they are to be used. The term “emergency code” is not used in the current regulations but applied frequently in practice. We plan to introduce the label into the regulations.

A7. We are also hoping to streamline the language concerning the issue of coding authorisations etc.

Appeals (regulation 11 and later provisions)

A8. It is not clear how Schedule 3 of TMA 1970 and the PAYE regulations combine to deal with appeals. And how the rules then apply to benefit claimants. We are looking at rewriting the provisions so that it is clear just what rules apply to the various appeals under the regulations.

Non-cumulative basis

A9. It is not totally clear how “week 1” codes relate to cumulative codes under the current regulations. And in some cases, the “week 1/month 1” basis does not necessarily mean that other tables should be used when deductions are to be calculated. We are considering introducing the term “non-cumulative basis” to make these provisions clearer.

A10. We are also looking at ways of clarifying the procedures relating to “week 53” payments under regulation 17(1)(a).

Record keeping

A11. A number of regulations seem to require the same information to be kept. We are looking at streamlining these requirements.

A12. In addition, there are a number of instances in which certain information is required according to the regulations, but not required in practice (and vice versa). We hope to overhaul these requirements so as to bring the law and practice in line.

Simplified PAYE scheme (regulation 20)

A13. This is being looked at by Personal Tax colleagues so we shall come back later to the question of recognising in legislation its somewhat wider scope in practice than would appear from the face of the regulation.

Tax-free payments (regulation 22)

A14. We are looking at the relationship between this regulation and the other deductions that need to be taken into account by employers.

P45s (regulation 23)

A15. This is currently a 4-part form with some information not being copied to all parts. However, the legislation does not make this clear. We are looking at ways of making it clear what information is required on each part of the P45.

Making the underlying scheme of Regulations 40, 41 and 42(6) more transparent.

A16. At first sight the formula in Regulations 40 and 41 looks simple:

$$(A+B) - (C+D)$$

A17. But it is complex because of factors such as B being conditional on the values of C in earlier period. And the formula requires users to understand and cross reference to other Regulations dealing with trade disputes. Similar factors affect Regulation 42(6)'s reference to "not include any amount for which a reduction was made in a payment under Regulation 40 or 41 in a previous income tax period". This complexity, and dispersal of provisions, may obscure the underlying scheme of accounting for PAYE. Broadly that, for employers unaffected by trade disputes, deductions made by the employer for a period are compared to repayments due from the employer for that period – and in relation to the difference a payment is "made to" or "received from" the Inland Revenue.

A18. We also want to see if it would be helpful to separate the "normal case" in Regulations 40/41 and 42(6) from the modifications that apply where "trade disputes" are an issue.

Under-deductions of tax which can be recovered from the employee

A19. This is presently dealt with by Regulations 42(2),(3) and 49(5). There is no indication from the Regulation headings that such recovery can be made. And Regulation 42 presently contains a number of arguably unrelated propositions. We want to see if it would be helpful to set out these provisions together.

means of delivering information (regulation 43)

A20. The means of delivering information is dealt with in the very first paragraph of Regulation 43 and, because of the way in which different methods of delivery have developed over time, there is also related material in paragraphs (1C), (3), (3A), (3B). Overall the material on *means of delivery* detracts from *what must be delivered*. We want to try to rationalise the way in which the means of delivery is set out. This will also affect Regulation 46 and any other Regulations where filing by EDI or Internet is permitted.

Regulation 44

A21. There looks to have been a missed consequential when the material presently contained in Regulation 44 was separated from the material presently in Regulation 43.

A22. We are looking also to tell people clearly by when returns must be made and what those returns should contain.

Making it easier to see when returns are required from employers (Regulation 46) and when from third parties (Regulation 46AB)

A23. We have received comments suggesting that it should be easier to see:

- a. what employers must report when; and

b. what someone else reports when.

A24. We will look for ways to do this. And also at other ways to make clearer other differences – for example how and when pay and tax are reported (the P35/P14 etc) as distinct from benefits in kind and expenses (the P9D/P11D etc).

Use of terms “collector”/”inspector”/”officer of the Board”

A25. In the Capital Allowances Act 2001 we generally replaced “inspector” by “the Inland Revenue” (meaning an officer of the Board) in line with the practice in recent years. We are looking at the possibility in the regulations of replacing similarly numerous references to “collector”, “inspector” and “officer of the Board” by “the Inland Revenue” – defined as appropriate.

Reduce the distraction of transitory material and remove obsolete material.

A26. We want to reduce the prominence of transitory material and remove material which will be obsolete for years covered by the rewrite. Examples are the provisions in regulations 50 and 53 for interest that cannot apply in relation to years after 5 April 1992 and 5 April 1996 respectively. And the reference in regulation 49(6) to interest under section 88 TMA 1970 which has no application for current years.

Local Councillors regulations 56-58

A27. It has occurred to us that there may now be less need for these regulations. That is of course a matter of policy but we shall be interested to hear in due course any views one way or another from councillors and their representative bodies.

Reserve Forces Pay Regulations 59-70

A28. As with the special provisions for councillors we shall be interested in any views on the continuing need for these regulations. But dropping them would be of course be a policy change.

A29. Apart from that there are points of detail within the regulations themselves where we shall be looking to align their wording and structure with the rest of the regulations.

Application of Regulations to Social Security Benefits

A30. Part VII of the Regulations is headed “Social Security Benefits”. In practice the regulations are applied to just two of the dozen or so benefits which are taxed under Schedule E. We have it in mind to make this clear to readers.

Incapacity Benefit: Determination of Emergency Code

A31. We are looking at the provisions for claims for (tax) allowances (that is, the personal allowance and blind person's allowance) in the light of how in practice people make claims to the Benefits Agency.

Incapacity Benefit: P45 not to be a "Code Authorisation"

A32. Usually a P45 handed in by an employee to a new employer is treated as a "code authorisation". This is not what is done if a claimant hands a P45 to the Benefits Agency. We are looking to make this clear in the regulations.

Section 203

A33. The legislation on which PAYE is founded was introduced in 1943. It has been consolidated since then without changes. We are looking at ways to rewrite it so it matches modern language and customs – but without changing what employers (and other payers) are required to do.

Section 203A

25. This section defines payment and says when a payment is made. It has a lot in common with section 202B (rewritten as clauses 4.50.10 and 4.50.11 in Exposure Draft No 6). We are looking to keep the language in step.

Sections 203B to 203L

A34. These are anti-avoidance provisions so our starting point is that changes to structure and order may well help readers but that changes in the law are even less likely to be appropriate than in our other work.