

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

PAYE REGULATIONS

EXPLANATORY NOTES

The commentary below covers the draft regulations in Annex B. The following table lists those draft regulations and indicates their origin.

<i>Draft Regulation</i>	<i>Heading</i>	<i>Based on Regulation</i>
<i>Making and effect of settlement agreement</i>		
80A	Board and employer may make PAYE settlement agreement	80A(1),(2)
80AA	Qualifying general earnings	80A(3),(4)
80E	Effects of settlement agreement	80E, 80A(5)
<i>Payment of tax under agreement</i>		
80F	Calculation of tax payable under agreement	80F
80G	Payment of tax and recovery proceedings	80G
80H	Formal determination of tax payable by the employer	80H
<i>Form and commencement of agreement</i>		
80B	Form of agreement	80B
80C	Commencement of agreement	80C
<i>Variation, review and cancellation of agreement</i>		
80D	Variation of agreement	80D
80L	Review of agreement	80L
80M	Cancellation of agreement	80M
<i>Interest</i>		
80J	Interest on unpaid tax	80J(1),(2),(5),(7), (8)
80K	Interest on overpaid tax	80K
<i>Records</i>		
80N	Inspection and retention of records	80N

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GLOSSARY

ICTA	the Income and Corporation Taxes Act 1988
draft Bill	the draft Income Tax (Earnings and Pensions) Bill published on 2 July 2002 for comments by 27 September 2002
TMA	the Taxes Management Act 1970

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CHAPTER 5 OF PART 6: PAYE SETTLEMENT AGREEMENTS (PSAs)

Overview

1. Section 206A ICTA gives the Board of Inland Revenue the power to make regulations about PSAs. Section 206A is rewritten as Chapter 5 of Part 12 of the draft Bill.

2. This Chapter of the draft regulations deals with PSAs which are voluntary agreements; voluntary in that neither an employer nor the Inland Revenue have to enter into them. PSAs provide for an employer to pay “grossed-up” tax on a limited range of earnings of employees and for that limited range of earnings to be excluded from the employee’s income for income tax purposes. Approximately the same amount of tax should be paid to the Inland Revenue as if the employees had been taxed on the limited range of earnings and benefits covered by the PSA. The advantage of PSAs lies in the administrative savings that are offered to all the parties concerned — employer, employees and Inland Revenue.

3. In more detail, the Chapter deals with:

- the general earnings (see paragraphs 10 and 11) that can be part of a PSA and also the conditions that must be satisfied before they can be included in an agreement. The effect of such an agreement on employees covered by the agreement and on the employer is set out (regulations 80A to 80E);
- the calculation of amounts payable to the Inland Revenue under a PSA and provisions for resolving disputes and recovering amounts so payable (regulations 80F to 80H);
- matters related to the form, commencement, variation, review and cancellation of a PSA (regulations 80B to 80M);
- interest on amounts paid late or overpaid (regulations 80J and 80K);
- the maintenance of records by an employer and their inspection (regulation 80N).

4. The numbers used for the draft regulations are purely provisional. For the most part those provisional numbers are the same as, or similar to, numbers used by corresponding material in Chapter V of Part VI of SI 1993/744.

5. The material on PSAs in SI 1993/744 is recent (1996) and there have been no substantial alterations to it. So there have not been additions which were not suited to the original structure of the PSA material. Which means that substantial changes to the material do not seem to be called for.

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

Agreements with “the Inland Revenue” rather than “the Board”

6. The draft Bill proposes to use “Inland Revenue” in a number of places where the reference in ICTA is to the “the Board”. This is summarised at page 10 of the Introduction and Commentary to the draft Bill as follows:

(24) Replacement of references to “the Board” with references to “the Inland Revenue”. In several clauses within this Bill where this is in line with practice, we propose to substitute the “Inland Revenue” for “the Board”. We seek views on this proposed rewrite change in Q7 on page 58, Q21 on page 120, Q30 on page 146, Q37 on page 186, Q55 on page 268, Q56 on page 272 and Q94 on page 400.

7. Entering into a PSA is another matter which may be and, in practice, is dealt with at appropriate levels within the Inland Revenue and not by the Board itself. We will therefore be proposing changes, in line with those listed in the extract in the previous paragraph, to clauses 693 and 694 of the draft Bill which reflect this practice.

8. At present the attached draft regulations continue to refer “the Board”. But we will revisit this aspect of the draft regulations.

Meaning of “employer”, “employee”, “emoluments” etc; use of “general earnings”

9. The words “employer” and “employee” have an extended meaning given to them in Regulation 2 of SI 1993/744, unless the context otherwise requires.

10. This Chapter is an instance where the context requires otherwise. Section 206A(9) of ICTA (clause 697 of the draft Bill) is framed in terms of certain “real” employments and offices and of emoluments (“general earnings” – clause 8(2) of the draft Bill) from such employments and offices.

11. And based on clause 697 of the draft Bill this Chapter uses the term “general earnings” in place of “emoluments” which is used in SI 1993/744.

12. Because it deals with “real” employers and “general earnings”, we anticipate that this Chapter will be unaffected by any changes that may in due course be proposed to the use of “employer”, “employee” and “emoluments” in the rest of the draft regulations.

Q1. We welcome comments on the proposal to use “general earnings” in this Chapter rather than “emoluments” as in SI 1993/744; and to make explicit that the terms “employer” and “employee” are used in this Chapter with the meaning that they bear in section 206A ICTA (clause 697 of the draft Bill).

MAKING AND EFFECT OF SETTLEMENT AGREEMENT

13. The three regulations under this italic heading deal with:

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

- the making of an agreement;
- the general earnings that can be covered by an agreement; and
- the effect of an agreement on the employer and employees.

Regulation {80A}: Board and employer may make PAYE settlement agreement

14. This regulation provides that the Board and an employer can make an agreement for a tax year in relation to “qualifying general earnings”. It is based on regulation 80A(1) and (2) of SI 1993/744.

15. The effect of such an agreement is that the employer’s obligations, in relation to those qualifying general earnings, are regulated by the terms of the agreement rather than the other parts of the PAYE regulations.

16. This regulation gives a label for such an agreement.

17. Regulation {80AA} deals with which “general earnings” can be “qualifying general earnings” and therefore capable of inclusion in a PSA.

Qualifying general earnings

18. The label “qualifying general earnings” is new. This label should make it easier to appreciate that there are limitations on what can be covered by a PSA.

Agreement relates to one year

19. This regulation puts up-front the fact that a PSA runs for just one tax year. SI 1993/744 Part VI Chapter V leaves that information to the second regulation.

The rest of these regulations

20. Regulation 80A(1) of SI 1993/744 refers to particular Parts of SI 1993/744 that are disapplied by a PSA, in relation to the employer being accountable for income tax in relation to emoluments covered by a PSA.

21. Paragraph (1) of this regulation refers instead to “the rest of these regulations”. That covers the specific Parts mentioned in SI 1993/744 containing provisions relating to accounting for income tax on emoluments. But it also covers all the other Parts of SI 1993/744. That should make no difference because there seems to be no material in those other Parts of SI 1993/744 relating to accounting for income tax on items potentially within a PSA (if there were any, they would also have been overridden to ensure that the PSA deals exhaustively with what an employer must pay in relation to earnings covered by the PSA).

<p>Q2. We welcome comments on the proposal that regulation 80A(1) refer to “the rest of these Regulations” rather than to specific Parts of these Regulations.</p>

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

Regulation {80AA}: Qualifying general earnings

22. This regulation sets out what are “qualifying general earnings”; only such earnings can be included in a PSA . It is based on regulation 80A(3) and (4) of SI 1993/744.

23. The two conditions that must be met by qualifying general earnings are set out in paragraph (1) of this regulation. They:

- limit the general earnings to expense payments or taxable benefits; and
- set out requirements for the general earnings to have specified minor, irregular or impracticable characteristics.

24. Paragraph (2) of this regulation provides a definition for Condition 1 and is based on the definition in clause 697 of the draft Bill (section 206A(9) of ICTA).

25. Paragraph (3) provides a pointer to a particular exclusion from qualifying general earnings. That exclusion relates to general earnings that should already have been subject to deduction of tax or which have been reflected in an employee’s code.

Separate regulation

26. Dealing with this material in a separate regulation and use of a label is intended to make clearer the restrictions on the earnings that can be covered by a PSA.

Detailed listing in regulation 80A(3)(a) of SI 1993/744 not reproduced

27. Condition 1 is based on regulation 80A(3)(a) of SI 1993/744 but it is less detailed. The various sections referred to in regulation 80A(3)(a) of SI 1993/744 are replaced by the draft Bill. Reproducing the various corresponding references in the draft Bill would produce a detailed listing that is unlikely to be informative or helpful to employers interested in entering into a PSA. So Condition 1 is based instead on the description of general earnings suitable for inclusion in a PSA according to clause {695}(b)(i) and (ii) of the draft Bill (section 206A(3)(b)(i) and (ii) of ICTA).

Regulation {80E}: Effects of settlement agreement

28. This regulation deals with the effects of a PSA. It is based on regulations 80E and 80A(5) of SI 1993/744.

29. The regulation provides:

- for items covered by a PSA to be excluded from income of the employees (paragraph (1));
- that employees cannot get any relief for sums that the employer has to pay in relation to a PSA (paragraph (4));

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

- for employees to be relieved of reporting requirements in relation to items covered by a PSA (paragraph (5));
- for employers to be relieved of certain reporting requirements in relation to items covered by a PSA (paragraph (6)).

Regulation heading and order

30. The words “consequential provisions” in the heading of regulation 80E of SI 1993/744 underplay the importance of the material contained in that regulation. The heading of this regulation is intended to be more informative.

31. This draft deals with the effect of a PSA earlier than the corresponding provision of SI 1993/744 for two reasons. Namely that:

- its contents are likely to be more important to most users than the form, commencement and variation material in regulations 80B to 80D of SI 1993/744; and
- the reordering allows readers to get to grips more quickly with what PSAs are trying to achieve.

Decompression of regulation 80E(1) of SI 1993/744.

32. There are essentially three propositions in regulation 80E(1) of SI 1993/744. They are broadly, in order:

- that an employee cannot have a deduction for an “expense” that is represented by earnings covered by a PSA (“first proposition”);
- that general earnings covered by a PSA are not included in the employee’s income for income tax purposes (“second proposition”); and
- that the exclusion of general earnings from an employee’s income does not affect the employer’s liability to make payments under a PSA (“third proposition”).

33. Of these propositions the most significant is the second proposition. That proposition has therefore been reflected in paragraph (1) of this regulation. The words “under Schedule E”, which follow “liability to income tax”, in regulation 80E(1) of SI 1993/744 have been dropped. That is a necessary consequence of the draft Bill dropping the concept of “Schedule E”. The meaning of the second proposition is unaffected.

34. The third proposition is reflected separately in paragraph (2) of this regulation.

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

The draft Bill removes the need for the first proposition in regulation 80(E)(1) of SI 1993/744.

35. The first proposition reads:

Emoluments of an employee included in a PAYE settlement agreement shall be treated as excluded from his income for the purposes of section 198 of the Taxes Act (relief for necessary expenses) ...

36. That proposition was not in draft regulation 80E(1) of the draft PSA regulations exposed for comments in a consultation document issued in March 1996. But draft regulation 80F of those 1996 draft PSA regulations allowed the employer, in calculating the sums payable to the Inland Revenue, to make certain deductions from emoluments covered by the PSA. Specifically draft regulation 80F of the draft 1996 regulations permitted the employer to make deductions to the extent that employees would have been able to make deductions under section 198 ICTA if the emoluments were not included in the PSA.

37. The intention of those 1996 draft PSA regulations seems clear. Employees were, by the nature of most items covered by a PSA, not going to be in a position to claim a deduction for matters represented by such items. The level of detail required for such claims by employees would call into question the rationale for agreeing to include the item in a PSA in the first place. But, since the objective of a PSA is to secure approximately the right amount of tax, draft regulation 80F allowed the employer to make estimated deductions, where appropriate, for “allowable expenses” in arriving at the amount payable by the employer under a PSA.

38. The subsequent (to March 1996) appearance of the first proposition in regulation 80E(1) of SI 1993/744 seems designed to *put beyond doubt* that two deductions are not allowed in relation to items included in a PSA. First, by the employer under regulation 80F of SI 1993/744. Second, by the employee under section 198 ICTA. The words “put beyond doubt” are used in the first sentence because the second proposition in regulation 80E(1) arguably made the first proposition unnecessary.

39. Whether or not strictly needed, the first proposition ensures that if, say, the reimbursement, of an expense, is within a PSA it is impossible for the employee to say that the expense has been defrayed out of emoluments of the employment. This in turn prevents a section 198 ICTA deduction for that expense.

40. The draft Bill uses different concepts than section 198 ICTA for there to be a deductible expense; albeit that the effect is intended to be the same. In particular the draft Bill replaces the requirement, in section 198 ICTA, that an expense has to be defrayed out of the emoluments with more appropriate conditions.

41. So clause {332}(2) of the draft Bill ensures that a deduction will not be given for expenses which are met out of reimbursements, or other payments, that are not included in the employee’s taxable earnings. And this also applies for benefits

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

because clauses {359} to {363} (read with clause {326}(2)(a)) of the draft Bill require the value of the benefit to be included in taxable earnings before a deduction will be given in relation to the benefit.

42. The draft Bill therefore prevents the employee from getting a deduction for items included in a PSA because expenses and benefits covered by a PSA will be excluded from the employee's taxable earnings by paragraph (1) of this regulation. That makes it unnecessary to reproduce the first proposition.

PAYMENT OF TAX UNDER AGREEMENT

43. The three regulations under this italic heading deal with:

- the framework for the calculation of sums payable under the PSA:
- the time for payment of such sums and the manner in which they can, if necessary, be recovered; and
- the way in which disputes about the sums payable can be resolved.

Regulation {80F}: Calculation of tax payable under agreement

44. This regulation deals with the factors that a PSA must take into account in the calculation of sums payable to the Inland Revenue by an employer. It is based on regulation 80F of SI 1993/744.

Being more explicit about "grossing up"

45. Regulation 80F(3) and (4) of SI 1993/744 can be confusing. At first sight it may appear that regulation 80F(4) of SI 1993/744 is providing for "grossing-up" (calculating the tax due having regard to the net sum or benefit retained by the employee). But closer examination reveals that it provides that the calculation in regulation 80F(3) of SI 1993/744 is to have regard to the marginal tax rates of the employees within the PSA. This draft regulation clarifies this (namely what regulation 80F(3) and (4) of SI 1993/744 are doing) by using a single paragraph (3) for that material.

46. Regulation 80F(4) is new. It states explicitly, but without being prescriptive, that a PSA has to provide for "grossing-up". That is what a significant number of readers may expect to see in this regulation. And this proposed addition will have no practical effect because the Inland Revenue will not agree a PSA that does not provide for "grossing-up".

<p>Q3. We welcome comments on the proposal that draft regulation 80F(4) state explicitly that "grossing-up" be provided for by a PSA.</p>
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These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

Regulation {80G}: Payment of tax and recovery proceedings

47. This regulation gives the date by which sums due under a PSA must be paid and applies procedures in Part VI of TMA where formal action is needed to recover the sums due. It is based on regulation 80G of SI 1993/744.

Regulation {80H}: Formal determination of tax payable by the employer

48. This regulation allows the Inland Revenue to issue a formal determination, where it appears that an employer has not paid all the tax due under a PSA, and applies procedures in TMA by which the employer can challenge such a determination. It is based on regulation 80H of SI 1993/744.

FORM AND COMMENCEMENT OF AGREEMENT

49. The two regulations under this italic heading deal with the form of a PSA, the date by which a PSA must be entered into and certain general earnings that may not be included in a PSA.

Regulation {80B}: Form of agreement

50. This regulation deals with the form of a PSA and certain matters that it must cover. It is based on regulation 80B of SI 1993/744.

Regulation {80C}: Commencement of agreement

51. This regulation gives the latest date by which a PSA for a tax year must be entered into and prevents a PSA from covering certain earnings. It is based on regulation 80C of SI 1993/744.

52. The earnings which a PSA may not cover are those from which PAYE was deductible before the PSA was entered into or those which have been reflected in an employee's code.

VARIATION, REVIEW AND CANCELLATION OF AGREEMENT

53. The italic heading sets out what the three regulations under this heading deal with.

Regulation {80D}: Variation of agreement

54. This regulation deals with variations of PSAs and the latest time at which variations can be made. It is based on regulation 80D of SI 1993/744.

Regulation {80L}: Review of agreement

55. This regulation requires the Inland Revenue to review the operation of a PSA by a set date. It is based on regulation 80L of SI 1993/744.

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

Regulation {80M}: Cancellation of agreement

56. This regulation sets out the circumstances in which the Inland Revenue can cancel a PSA and some of the effects of such a cancellation. It is based on regulation 80M of SI 1993/744.

Making explicit the effect on employees of cancelling a PSA

57. Paragraph (3) is explicit that the employer cannot benefit from a PSA in relation to matters occurring after receipt of a notice cancelling the PSA. It is implicit in paragraph (3) that an employee also cannot benefit in relation to those same matters. That follows from first a consideration of what PSAs are intended to achieve and second, no provision being made for the employer to isolate earnings that have to be included on returns P45/P60/P14 and P11D (being earnings that would otherwise have been excluded by the cancelled PSA). It may be helpful to readers for the regulations to deal with this aspect explicitly.

Q4. We welcome comments on the suggestion that the regulations deal more explicitly with the effect on employees of cancelling a PSA.

INTEREST

58. The two regulations under this italic heading deal respectively with interest payable to or by the Inland Revenue in relation to a PSA.

Regulation {80J}: Interest on unpaid tax

59. This regulation charges interest on sums payable under this Chapter by an employer but which are not paid by 19 October following the tax year to which the PSA relates. It is based on regulation 80J(1), (2), (5), (7) and (8) of SI 1993/744.

60. The regulation gives the amount on which, and period for which, interest runs, the rates to be used and methods to use where formal action is required to recover unpaid interest.

Merging 80J(1) and (2) of SI 1993/744.

61. It seems clear that regulation 80H (formal determination) of SI 1993/744 is about the process by which the aggregate amount payable under regulation 80G(1) of SI 1993/744 can be determined, where the Inland Revenue and the employer cannot agree that amount. As such 80J(2) of SI 1993/744 is unnecessary and unhelpful; unhelpful because readers may be tempted to waste time trying to rationalise its existence.

62. Paragraph (1) of this regulation therefore takes a slightly different approach. It provides that interest is due where amounts payable under this Chapter in relation to a PSA remain unpaid after 19 October following the tax year to which the PSA relates. That covers in one paragraph the material presently in regulation 80J(1) and 80J(2) of SI 1993/744.

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

63. An alternative approach would have been to drop 80J(2) and reproduce 80J(1), essentially unchanged, of SI 1993/744. That ought to work. But it might in the future tempt someone to advance the argument that dropping 80J(2) of SI 1993/744 was a “mistake” that had created an “anomaly”.

Regulation 80J(3), (4) and (6) and 80K(3) of SI 1993/744

64. It is intended to deal with this material on certificates and cheques in a regulation dealing more generally with such matters.

Regulation {80K}: Interest on overpaid tax

65. This regulation provides for the Inland Revenue to pay interest to the employer on certain overpayments that the employer makes in relation to sums due under a PSA. It is based on regulation 80K(1) and (2) of SI 1993/744.

RECORDS

Regulation {80N}: Inspection and retention of records

66. This regulation deals with the retention of records relating to a PSA, the period for which they must be retained, the inspection of those records and matters related to copying or removing such records. It is based on regulation 80N of SI 1993/744.

These notes refer to Chapter 5 of Part 6 of the draft PAYE regulations as at 10 October 2002.

SUMMARY OF QUESTIONS

- Q1. WE WELCOME COMMENTS ON THE PROPOSAL TO USE “GENERAL EARNINGS” IN THIS CHAPTER RATHER THAN “EMOLUMENTS” AS IN SI 1993/744; AND TO MAKE EXPLICIT THAT THE TERMS “EMPLOYER” AND “EMPLOYEE” ARE USED IN THIS CHAPTER WITH THE MEANING THAT THEY BEAR IN SECTION 206A ICTA (CLAUSE 697 OF THE DRAFT BILL). 4
- Q2. WE WELCOME COMMENTS ON THE PROPOSAL THAT REGULATION 80A(1) REFER TO “THE REST OF THESE REGULATIONS” RATHER THAN TO SPECIFIC PARTS OF THESE REGULATIONS..... 5
- Q3. WE WELCOME COMMENTS ON THE PROPOSAL THAT DRAFT REGULATION 80F(4) STATE EXPLICITLY THAT “GROSSING-UP” BE PROVIDED FOR BY A PSA..... 9
- Q4. WE WELCOME COMMENTS ON THE SUGGESTION THAT THE REGULATIONS DEAL MORE EXPLICITLY WITH THE EFFECT ON EMPLOYEES OF CANCELLING A PSA. 11