

These notes refer to the DRAFT PAYE regulations as at 7 January 2003

PAYE REGULATIONS

EXPLANATORY NOTES

The commentary below covers the draft regulations in Annex B. The table following lists those draft regulations.

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GLOSSARY

This commentary uses the following abbreviations:

SI 1993/744	The Income Tax (Employments) Regulations 1993 (as amended)
rewrite Bill	the Income Tax (Earnings and Pensions) Bill as introduced in the House of Commons on 5 December 2002 (Bill 13)
SI 1994/1212	The Income Tax (Employments) (Notional Payments) Regulations 1994
TMA	the Taxes Management Act 1970

QUESTIONS ON THE DRAFT REGULATIONS

The commentary invites comments on changes in the law proposed in the draft regulations and on a few other points. There is a summary of these questions on page 20 of this commentary.

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Part 6: Special provisions

Overview

1. This Part sets out special PAYE provisions for two special situations and four classes of income.
2. Chapter 1 provides continuity for PAYE on:
 - the death of a person operating PAYE; and
 - a succession to a business.
3. Chapters 2 to 5 provide alternatives to the normal operation of PAYE for four classes of payments:
 - certain allowances paid to councillors (Chapter 2);
 - payments to members of the reserve forces (Chapter 3);
 - payments by holiday pay funds (Chapter 4); and
 - payments and other income where dealt with by a PAYE settlement agreement (PSA) (Chapter 5).
4. Chapters 2 to 4 provide for a modified and simpler system of deduction of tax at the basic rate on the non-cumulative basis. Chapter 5 provides for voluntary agreements between an employer and the Inland Revenue under which an employer pays the “grossed-up” tax on a limited range of earnings of employees which then do not count as income for PAYE (or other tax) purposes.

Background

5. The draft regulations in this Part are based on Part VI of SI 1993/744 with minor changes to bring them into line with practice.
6. We published a draft of Chapter 5 of this Part in October 2002. Those draft regulations are not included in Annex B but are available from the Inland Revenue’s website or from the Tax Law Rewrite project.

Headings and organisation of these regulations

7. These draft regulations are presented as one Part for ease of comparison with the current regulations in SI 1993/744. The structure is however expected to change. For example the regulations in Chapter 1 here between them potentially affect all employers. So we envisage moving them to an earlier “core” Part of the regulations.

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8. 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 Part VI of SI 1993/744.

9. Some of the headings differ slightly from those used in SI 1993/744 in order to convey better what the regulation is about.

Statutory references

10. The draft regulations refer to provisions in the “2003 Act”. This is the Act which is expected to result from the Income Tax (Earnings and Pensions) Bill introduced in the House of Commons on 5 December 2002 (Bill 13) (referred to in this commentary as the “rewrite Bill”).

meaning of “employer”, “employee”, “emoluments” etc

11. The words “employer” and “employee” have an extended meaning given to them in Regulation 2 of SI 1993/744, unless the context otherwise requires. That extended meaning applies in Chapter 1. We shall be inviting views on ways this might be made clearer. Interpretation of “employer” and “employee” is not an issue in Chapters 2 to 4 because the terms have been avoided and the name of the specific type of employer is used instead.

12. The term “emoluments” also has a special, defined meaning for the PAYE regulations (and one which is not the same as its meaning in other legislation). In these draft regulations the term “net PAYE income” is used instead. We shall be inviting views separately on that along with other rewritten definitions for the regulations. Those other definitions will include a replacement for “payments of emoluments” (and other references to emoluments paid) which also has a special meaning in the PAYE regulations. In the meantime these draft regulations retain (in square brackets) references to “emoluments” in the context of payments.

Use of “Inland Revenue” in the regulations

13. This draft replaces the term “inspector” by “the Inland Revenue”, meaning any officer of the Board.

14. Since the 1993 consolidation of the PAYE regulations, the terms “collector” and “inspector” have normally been avoided in tax legislation. In 1995 this was explained, under the heading “Statutory References”, in “SAT2 (1995) : Self Assessment: the legal framework” as follows:

Meaning of ‘Officer of the Board’

The term ‘Officer of the Board’ is used in the new legislation in place of the more traditional terms ‘Inspector’ and ‘Collector’. This is because the introduction of Self Assessment coincides with a change programme within the Inland Revenue that includes a very extensive internal reorganisation. New ways of working will mean that people in the Revenue will not be restricted to working within the old specialisms. But the officers of the Board who perform the work will be of similar rank and training to those who perform analogous tasks today.

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15. Earlier references to “inspector”, in legislation dealing with capital allowances, were omitted from CAA 2001 in favour of “the Inland Revenue” (defined in section 576 of that Act). This was explained in Annex 1 to explanatory notes to that Act as follows:

Change 64 The Inland Revenue and tax inspectors: section 576(1)

Section 576(1) provides that “the Inland Revenue” means any officer of the Board of Inland Revenue.

The effect of this, in relation to some provisions in the Act, is to enable things to be done by or in relation to an officer of the Board instead of (as would be the case under the corresponding provisions of CAA 1990) by or in relation to an inspector. (The change does not affect what can be done by or in relation to the Board of Inland Revenue.)

This change is a minor one because a similar result could in many cases be achieved by a different means under section 1(2B) of TMA 1970. Under section 1(2B), a person who is not an inspector may exercise functions conferred on inspectors, if, in accordance with the Board’s administrative practices, he has been authorised to act as an inspector for specific purposes.

16. A similar change is proposed in the rewrite Bill (see Change 158 of Annex 1 to the Explanatory Notes accompanying the rewrite Bill).

17. Rewriting the PAYE regulations provides an obvious opportunity to remove the dated references to “inspector” that currently exist. This would also make the regulations more transparent for users who are not familiar with section 1 of TMA. This is a change in the law (*Change 1*) but not in practice as the Inland Revenue would, as now, restrict authority to do things under the regulations to staff with the appropriate training

<p>Q1. We welcome comments on the proposal to replace references to “inspector” by “the Inland Revenue” – defined to mean an officer of the Board. (<i>Change 1</i>)</p>

Chapter 1 : Death of employer and succession

Overview

18. This Chapter provides continuity in the operation of PAYE when an employer dies (regulations 79 and 79A) or a business changes hands (regulations 80 and 80A).

Regulation 79: Death of employer

19. This regulation deals with the death of an employer. It is based on regulation 79(a) of SI 1993/744.

20. If an employer dies someone needs to assume responsibility for the sundry PAYE obligations, such as issuing P45s, paying the tax and doing end of year returns. This regulation provides an explicit rule for this.

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21. *Paragraph (2)* provides that regulation 79A applies instead if the employer was making payments for PAYE purposes on behalf of another person. The material in regulation 79 of SI 1993/744 has been split between the two draft regulations to make it easier for readers to see the two distinct sets of circumstances. The application of this regulation to notional payments is discussed in paragraph 37.

Regulation 79A: Death of employer paying [net PAYE income] on behalf of another

22. Regulation 79A deals with the death of someone who was paying net PAYE income on behalf of another person. It is based on regulation 79(b) and (c) of SI 1993/744.

23. As noted in paragraph 21, this material has been split from that dealt with by draft regulation 79 in order to make clearer the different circumstances.

24. This regulation is far less likely to apply in practice than draft regulation 79. An example of where it would apply is an individual who makes payments on behalf of another, and who operates PAYE as the “employer” for the purposes of the regulations. On the death of that person paragraph (2)(a) of this regulation (like regulation 79(b) of SI 1993/744) requires the PAYE obligations to be picked up by the payer’s successor.

25. But the regulation also caters for circumstances where there is no successor (in the sense of a new person making payments on behalf of another). Then paragraph (2)(b) (like regulation 79(c) in SI 1993/744) requires the person on whose behalf the income was being paid (normally the real employer) to fulfil the PAYE obligations.

26. Regulation 80: Succession to a business etc

27. This regulation deals with the succession of an employer. It is based on regulation 80 of SI 1993/744.

28. The material in regulation 80 of SI 1993/744 has been split between this regulation and regulation 80A so the latter can deal separately with the special circumstances of a succession during a trade dispute. The material in this regulation has also been re-ordered to clearer effect. This is that a succession is not treated as a change for the purposes of PAYE so:

- employees, pensioners and others getting PAYE income do not get P45s (which they would then have to hand in to the “new employer”); and
- the PAYE scheme runs on with the new employer picking up the deductions working sheets, accounting for tax and making end of year returns after the succession.

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29. Paragraphs (2) and (3) set out the circumstances in which this regulation applies. They are based on regulation 80(1) of SI 1993/744. Two paragraphs are used here to make it clearer in paragraph (2) that this regulation applies to a change in the person paying the *same* pension.

interaction of regulations 79 and 80 of SI 1993/744

30. The term “employer” here, as in regulation 80 of SI 1993/744, must take the meaning defined in regulation 2 of SI 1993/744 – ie a person making payments of PAYE income. Otherwise the regulation makes little if any sense in relation to pensions. But this would mean that the regulation also applied where there has been a change in the person making payments on behalf of another person. These are circumstances covered separately by regulation 79 in SI 1993/744 (see draft regulations 79 and 79A). If a person paying net PAYE income on behalf of another person died and someone succeeded the deceased to carry on the business both regulations would apply.

31. Paragraph (3) removes this potential conflict between draft regulation 79A and this regulation. It provides that this regulation does not apply if the reason for the change is the death of the person who has been paying net PAYE income on behalf of the employer. This leaves regulation 79A to apply. This change (*Change 2*) has no effect in principle or practice given that both regulation 79A and regulation 80 provide continuity for PAYE purposes.

<p>Q2. We welcome comments on the proposal to apply only regulation 79A where there is a succession to an intermediary. (<i>Change 2 in regulation 80</i>)</p>

notional payments

32. Paragraph (6) is new. It makes clear that PAYE on “notional payments” must be accounted for by the person who was the employer at the time the payment was made.

33. Notional payments arise on certain transfers of assets to employees and other events (see sections 203B to 203J of ICTA or Chapters 3 and 4 of the rewrite Bill). There are special provisions for PAYE in respect of them. In summary, the employer must treat the notional payment in the normal way for PAYE purposes, deducting the tax from other (ordinary) payments made to the employee at the same time or later in the same income tax month or quarter. See section 203J of ICTA (or clause 710 of the rewrite Bill) and regulation 7 of SI 1994/1212.

34. If the employer cannot do so, because there are insufficient such payments, section 203J(3) (clause 710(3) and (4)) and regulation 8 of SI 1994/1212 require the employer to account for the tax which cannot be deducted by 14 days after the end of the income tax month or quarter.

35. Regulation 13 of SI 1994/1212 applies parts of SI 1993/744 for the purposes of notional payments but not Part 6. This leaves the obligation to account for tax on a

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notional payment with the predecessor. This makes sense given the special nature of notional payments. Unlike the ordinary operation of PAYE, deduction and payment cannot always go hand in hand.

36. The provisions for notional payments from SI 1994/1212 are included in the rewrite Bill with the balance to be included in these regulations, so users have all the PAYE legislation in two chunks. In the absence of any special provision this regulation might then be read as applying also to notional payments, making the successor liable for tax the predecessor could not deduct. Paragraph (6) prevents that and maintains the current law. The proviso “unless those [emoluments] were paid by the new employer” caters for the exceptional circumstances where the successor employer is also the employer (as defined in section 203L of ICTA – see clause 712 of the rewrite Bill) who is treated as making the notional payment. In the process it makes that a person who makes a payment other than a notional payment before succeeding to a business cannot then deny responsibility for PAYE on that payment.

37. A similar point arises with notional payments and regulation 79 of SI 1993/744. If an employer makes a notional payment then regulation 13 of SI 1994/1212 does not apply regulation 79 of SI 1993/744 to require the personal representatives to account for tax. The draft of regulation 79 will do so. It will apply to tax in respect of notional payments as to other payments. This change (*Change 3*) makes clear the position of personal representatives in such circumstances and is in line with the responsibilities of personal representatives in relation to a person’s income tax and capital gains tax generally. It is expected to have no practical effect as the point has not arisen in practice so far as the Inland Revenue knows, but is what it would, if asked, have advised personal representatives to do.

Q3. We welcome comments on the proposal to make explicit who, on the death of an employer or succession to a business, is to account for tax in respect of notional payments. (*Change 3 in regulations 79 and 80*)

38. Regulation 79A will however not apply to give rise to an obligation in respect of notional payments on the successor to a person making payments on behalf of another. This is because of the way the employer for the purposes of PAYE on such payments is defined by section 203L of ICTA and clause 712 of the rewrite Bill. This will be made clear when regulation 13 of SI 1994/1212 is rewritten.

Regulation 80A: Succession to a business: trade disputes

39. This regulation deals with the succession of an employer whilst a trade dispute is taking place. It is based on regulation 80(4) of SI 1993/744.

40. This material has been separated from the rest of regulation 80 of SI 1993/744 for clarity as it very rarely applies in practice. It deals with the effect of the succession on parts of other regulations that apply when there is a trade dispute. The references to those other regulations are Part 5 published in draft in July 2002 with our third progress report – paper SC/CC(02)11.

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41. *Paragraph (2)* provides for the former employer to comply with the regulations as if the trade dispute had ended when the new employer takes over. That is, the former employer must pay over to the Inland Revenue any tax held back and not repaid during the strike; and make any additional return required in cases of a trade dispute in respect of such tax.

42. *Paragraph (3)* requires the employer after the succession to repay at the end of the trade dispute any PAYE repayments withheld by the former employer. The new employer is entitled to recover these payments from the Inland Revenue under regulations 40(2) and 40B(4).

Chapter 2: Councillors' allowances

Overview

43. This Chapter gives councillors the option of having certain allowances paid to them under deduction of tax at the basic rate rather than under the normal PAYE process. Regulation 56 defines the allowances in question and other terms used in the Chapter. Regulation 57 provides the option for councillors to elect for deduction at the basic rate, and for the Inland Revenue to tell councils paying the allowances. Regulation 57A requires a council paying allowances under this arrangement to keep records. Regulation 58 treats the election for tax to be deducted at the basic rate as the issue of a basic rate code so as to apply other regulations which turn on there being a code – eg the issue of P45s and P60s.

Material omitted

44. This draft Chapter omits regulation 58 of SI 1993/744 as unnecessary. That applies Part V for the purposes of tax deducted from councillors' allowances under the special provisions. That was necessary in the original regulations (SI 1974/340). They were free-standing regulations made after the 1973 consolidation of the Employment Regulations (1973 No. 334). It was not necessary when the regulations were consolidated in 1993. But the fact that it had become unnecessary was overlooked in 1993.

Regulation 56: Interpretation of Chapter 2

45. This regulation defines terms used in this Chapter. It is based on regulation 56 of SI 1993/744.

46. Regulation 56 of SI 1993/744 opens with a proviso that the definitions apply “unless the context otherwise requires”. This draft regulation omits this as unnecessary. There is nowhere in this Chapter where the words defined require a different meaning.

47. Paragraph (2) contains definitions which are only used for the purposes of the definitions in paragraph (1). They have been put in a separate paragraph to make matters clearer.

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48. Paragraph (1) includes a change in the law to bring the meanings of allowances into line with practice. Chapter I of Part VI of SI 1993/744 applies only to “attendance allowance”. But since the provisions were introduced in 1974 local government legislation has provided for the payment of other allowances. This draft regulation reflects that. The heading of the Chapter now refers only to “Councillors’ Allowances”. The definition of “allowances” covers also the basic, special responsibility, conference, and care allowances paid to some councillors. Inland Revenue practice is to allow councillors to opt for taxation at basic rate on all these allowances. This is a change in the law (*Change 4*), but not in practice. And it would remain open to any councillor not to make use of the option offered by this Chapter. It is also administratively simpler at the point of payment if the option for basic rate deduction applies to the different allowances a councillor may receive in one sum.

49. In the definition of “allowances” and “councillor” the references to the local government provisions under which the allowances are paid have been updated to reflect these other allowances to which deduction at the basic rate can apply.

Q4. We welcome comments on the proposal to extend the option offered by this Chapter beyond attendance allowance to the other allowances. (*Change 4 in regulation 56(1)*)

50. Some of those local government provisions include allowances for travelling and subsistence and other expenses as well as an attendance allowance. Whilst it makes sense to bring in the other allowances which are clearly taxable, we do not want to suggest that tax must be deducted at the basic rate from the expenses payments. There are various ways in which this could be achieved:

- the expenses payments could be included in the meaning of allowances in Part 6 but only to the extent they are payments for PAYE purposes (leaving dispensations and/or the new definition of excluded business expenses to take them out of PAYE in practice).
- the expenses payments could be included in the meaning of allowances in Part 6 but the Inland Revenue could then notify the council to disregard an appropriate proportion of the allowances, i.e. the travel and subsistence element, as provided for by regulation 57(4). However, this risks more work as it would be necessary to give a direction to all payers of that allowance – unlike the proposed definition of excluded business expenses there is no provision for a direction to all councils at once.
- the expenses allowances could be excluded from the meaning of allowances in Part 6. This would restrict these regulations to the attendance element of the payment where a local government provision provides for both attendance allowance and expenses, usually travelling and subsistence allowances. This means the expenses payments stay subject to Parts 3 and 4. So any which are neither covered by dispensations nor by the proposed definition of “excluded

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business expenses” would be subject to PAYE in the ordinary way and require a code - frustrating the purpose of Part 6. But in practice most or all would probably just be overlooked apart from the P11D.

51. This last is the approach adopted in this draft which specifically refers only to the attendance allowance where a local government provision includes both that and travelling and subsistence payments, to make clear that only the attendance part of the allowance will be subject to deduction at the basic rate. However, we accept that the definition of “allowances” would be simpler if the option in the first bullet point was adopted.

<p>Q5. We welcome comments on whether Chapter 2 should apply to the expenses payments in the same way as other allowances.</p>

52. Paragraph (1) also defines “local council” where SI 1993/744 defines “employer”. This reminds readers of this Chapter that it is dealing only with payments made by one of the specified bodies.

Regulation 57: Councillor’s option to have tax deducted at basic rate.

53. This regulation provides that a local councillor can elect to have basic rate tax deducted from his attendance allowance and not have PAYE operated on it. It is based on regulation 57 of SI 1993/744.

54. Regulation 57(2) of SI 1993/744 requires councillors to be “aggrieved” by their PAYE codes in order for them to opt for deduction at basic rate from their allowances. This requirement is omitted as unnecessary (as the similar requirement was omitted from the draft of regulation 11 published in April).

55. Paragraph (3) includes “on the non-cumulative basis” for clarification.

56. For clarification Paragraph (5) refers to the clauses of the rewrite Bill which provide for deductions from earnings for expenses. Regulation 57(5) of SI 1993/744 refers only to where “the councillor may be obliged to expend money wholly, exclusively and necessarily in the performance of his duties as a councillor” leaving readers to make their own link to the legislation for expenses.

Regulation 57A: Local council to keep records

57. This regulation requires a council to keep records of allowances paid to councillors who have opted to have tax deducted at the basic rate. It is based on regulation 57(6) and (7) of SI 1993/744.

58. These record-keeping provisions have been separated from the draft regulation 57 as they deal with the consequences for the council of the councillor’s election.

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59. Paragraph (2) requires the council to record the councillor's name and National Insurance number (NINO). This is a change in the law (*Change 5*) but one that should be of benefit to the councillor, and brings the regulation into line with, for example, regulation 38 of SI 1993/744.

Q6. We welcome comments on the proposal to require the councillor's national insurance number and name on the deductions working sheet. (*Change 5 in regulation 57A*)

Regulation 58: Regulations apply as if basic rate option were the issue of a code

60. This regulation provides for the PAYE regulations to apply where a councillor elects for tax to be deducted at the basic rate as if the Inland Revenue had issued a basic rate code. It is new.

61. Chapter I of Part VI of SI 1993/744 requires deduction of tax at the basic rate but does not deem the Inland Revenue to have determined a code. This means that the council is not required under regulation 23 of SI 1993/744 to issue a P45 when a councillor ceases to hold office. The council may also have difficulty with other regulations which require the code to be shown on, for example, P60s (regulation 39 of SI 1993/744) and P14s (regulation 43 of SI 1993/744). This change (*Change 6*) overcomes any difficulty in applying the other PAYE regulations where they refer to the code appropriate to the employee.

62. The new term "basic rate code" was proposed in the draft regulations published in April and will be defined for the regulations as a whole.

Q7. We welcome comments on the proposal to treat the option for basic rate as if a basic rate code had been issued. (*Change 6 in regulation 58*)

CHAPTER 3 :RESERVE AND AUXILLIARY FORCES

Overview

63. This Chapter provides a simplified form of PAYE for payments to members of the reserve and auxiliary forces. Payments are made with basic rate tax deducted or with no tax deducted.

64. Regulation 59 defines the payments to which this scheme applies and other terms. Regulation 60 provides that the normal provisions for deductions, P45s, P46s and so on do not apply. Regulations 61 and 62 require basic rate tax to be deducted from payments unless the Inland Revenue determine the pay will not all be liable to tax. Regulations 63 to 64 provide for reservists to object to deduction of tax at the basic rate, for appeals to the independent General Commissioners, and for the Inland Revenue to amend its determination if the reservist's circumstances change.

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65. Regulations 65 and 66 provide for repayments to reservists during a tax year. The first gives reservists the right to a certificate of pay and tax deducted. The second provides for repayments by the Inland Revenue during a tax year.

66. Regulation 67 requires a deductions working sheet for each reservist. Regulation 68 provides for each reservist to get a certificate of tax deducted after the end of the tax year.

67. Regulation 70 makes clear none of this affects the operation of PAYE on a reservist's other PAYE income.

Regulation 59: Interpretation of Chapter 3

68. This regulation sets out the forces to which this chapter applies and provides the definitions of terms used in the chapter. It is based on Regulation 59 of SI 1993/744.

69. In paragraph (1) Department *for* Transport has been substituted for the Department *of* Transport in the definition of "Ministry".

70. In paragraph (2) the references to "officers of the retired and emergency lists of the Royal Navy and Royal Marines" and "Regular Army Reserve of Officers" have been dropped as such reservists are only paid when serving full-time, and under the usual PAYE arrangements via the same payroll as fulltime, serving members. Applying these regulations to them would very probably result in them paying too much or too little tax through PAYE – in contrast to the result for "normal" reservists. This is a change in the law (*Change 7*) to bring the regulation into line with practice.

Q8. We welcome comments on the proposal to remove officers of the retired and emergency lists of the Royal Navy and Royal Marines, and officers of the Regular Army Reserve of Officers from the scope of this regulation. (*Change 7 in regulation 59(2)*).

Regulation 60: Application of other parts

71. This regulation disapplies Parts 3 and 4 of these regulations for reserve pay and applies the rest of the regulations as if a basic rate code had been issued. It is based on regulations 60 and 69 of SI 1993/744.

72. The disapplication or otherwise of other Parts of the regulations is brought together here: Parts 3 and 4 are disapplied, so there is no issue of P45s for example, and the rest of the regulations are applied as if a basic rate code had been issued. Regulation 69 of SI 1993/744 provides for Parts 5 and 8 to apply with any necessary modifications. The only modifications required are to cater for the fact that there is no code to put on returns. This change (*Change 8*) provides a deemed code for the return. This change will have no practical effect. (The draft regulations published in April proposed to define formally the "basic rate code" as one of the special codes.)

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Q9. We welcome comments on the proposal to apply the rest of these regulations as if a basic rate code had been issued. (Change 8 in regulation 60).

Regulation 61: Deduction of tax

73. This regulation requires the Ministry to deduct income tax at the basic rate from payments of reserve pay, unless the Inland Revenue tell it that no tax is to be deducted. It is based on regulation 61 of SI 1993/744.

74. Paragraph (3) of regulation 61 of SI 1993/744 has been dropped as unnecessary. That provides that regulation 8 of SI 1993/744 (which requires employers to carry on using a PAYE code if no new code is issued for a new tax year) does not apply to a notice from the Inland Revenue not to deduct tax from reserve pay. It originated in an amendment to the original regulations for reserve pay (SI 1975/91) made by SI 1981/44 when, what is now regulation 8, was introduced. It may then have been thought helpful to emphasise that that provision did not apply to reservists; or it may have been overlooked that the regulation in question did not apply to reserve pay. Either way, there is no need to single out Regulation 8 for special mention.

Regulation 62: Determination by inspector

75. This regulation provides for the Inland Revenue to make a determination that tax is not to be deducted if the reservist will not be liable to income tax on all of the reserve pay. It is based on regulation 62 of SI 1993/744.

76. The purpose of this regulation is to avoid over-deductions of tax from reserve pay. For example, if a reservist has no other income it would be manifestly wrong for tax to be deducted at the basic rate. For reservists with only modest other PAYE income it may also be wrong to deduct tax at the basic rate so they end the year owed a repayment. Conversely it would offer reservists poor service if tax was not deducted from their reserve pay solely because their other income was not PAYE income. They would then end the year owing tax. So regulation 62 of SI 1993/744 provides for the decision on whether or not reserve pay will be liable to tax on the assumption that personal allowances are allocated first to other income (whether or not PAYE income).

77. This is in line with the way the original PAYE system was expected to deal with minor sources of other income by allocating allowances to them – what is known as “coding out” the other income. But the primary legislation for PAYE (in Chapter 2 of Part 11 of the rewrite Bill) does not expressly provide for the regulations to have regard to income other than PAYE income. A similar point arises on regulation 7 of SI 1993/744 with “coding out” of other income. We proposed in the draft regulations published in April a minor change to bring that regulation into line with practice and allow non-PAYE income to be “coded out” unless the taxpayer objects. It depends on changes to the primary legislation. Whether those changes will be proposed in a future Finance Bill is of course a matter for Ministers. But in order to show better how the

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changes would be followed through to the PAYE regulations this draft regulation also provides for such other income to be taken into account when deciding if tax should be deducted from reserve pay at the basic rate –subject to the reservist’s objection. This is a change in the law (*Change 9*) to bring it into line with practice. It will have no practical effect and the right for reservists to object will protect their position.

Q10. We welcome comments on the proposal to make clear that non-PAYE income can be taken into account when determining whether tax at basic rate is to be deducted from reserve pay, and to give reservists a right to object to such income being taken into account. (*Change 9 in regulation 62*)

Regulation 63: Objection against deduction of tax

78. This regulation gives reservists the right to object to deduction of tax at the basic rate and to appeal if they and the Inland Revenue cannot agree. It is based on part of regulation 63 of SI 1993/744.

79. Regulation 63 of SI 1993/744 has been split, and re-written along the lines of draft Regulation 11 published in April so that the provisions relating to the conduct of appeals against the Inland Revenue’s determination are now in draft regulations 63A and 63B.

80. An objection is a notice from the reservist to the Inland Revenue objecting to reserve pay being taxed at basic rate. An appeal is against the Inland Revenue’s determination following the objection. This is a difference from regulation 11 where the employee can object to any code.

81. Paragraph (2) spells out that the determination is made using the same assumptions as in regulation 62.

Regulation 63A: Appeal to Commissioners

82. This regulation states what the Commissioners should do on appeal. It is based on part of regulation 63 of SI 1993/744.

83. This regulation is drafted in the same way as draft regulation 11(5) published in April 2002. Regulation 63 of SI 1993/744 allows a right of appeal against the inspector’s determination to either the General Commissioners or the Special Commissioners (old regulation 63(4)). This regulation provides for the appeal to go only to the General Commissioners. This brings the regulation into line with Regulation 11(3) for appeals concerning PAYE codes; and with all other appeal rights in the regulations. This change (*Change 10*) in the law is in principle restricting the right of reservists to access the Special Commissioners but preserves their rights to an appeal to an independent appeal body but has no, or negligible practical effect, as, so far as can be established, no appeal has ever been taken to the Special Commissioners.

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Q11. We welcome comments on the proposal to provide for all appeals to be to the General Commissioners. (Change 10 in regulation 63A)

Regulation 63B: Appeals- supplementary provisions

84. This regulation provides for an appeal to be heard by the General Commissioners where the reservist lives. It is based on regulation 63(5) and (6) of SI 1993/744.

85. This regulation makes explicit that Schedule 3 of TMA applies. This change (*Change 11*) is akin to that in draft regulation 11A mentioned in paras 135-141 of the Second Progress Report issued in April. Regulation 63(5) of SI 1993/744 stipulates that an appeal is to be heard by the division of General Commissioners for the place of residence, subject (in subsection (6)), to a right to elect for the appeal to be heard by General Commissioners for a specified division, as provided for by s44(2) TMA 1970. It says nothing about the rules in Schedule 3 of TMA 1970 which govern the place where PAYE appeals are to be heard. Paragraph 3(1)(b) of those rules allows the appellant to elect for the place of business or the place of employment in the UK, as well as place of residence, notwithstanding the place specified by the PAYE regulations. In this instance that is regulation 63. By specifying that the place of residence is subject to that right to elect for the place of business or employment provided by paragraph 3(1)(b) of Schedule 3 TMA 1970 the regulation is brought into line with Regulation 11A.

86. The change benefits the taxpayer by providing the appellant with a right to elect for the division that is most convenient instead of having to agree the division with the other parties to the appeal, as provided by s44(2)TMA 1970, although that avenue remains available.

Q12. We welcome comments on the proposal to make explicit that the rules in Schedule 3 to TMA 1970 may be applied in respect of appeals made against a determination to deduct tax at the basic rate from reservists' pay. (Change 11 in regulation 63B)

Regulation 64: Amended determinations

87. This regulation provides for the Inland Revenue to amend determinations if the reservist's circumstances change. It is based on regulation 64 of SI 1993/744.

Regulation 65: Certificate of tax deducted

88. This regulation provides for a certificate of payments and tax deducted to be given to the reservist. It is based on regulation 65 of SI 1993/744.

Regulation 66: Repayment to reservist during the year

89. This regulation deals with in-year repayment of tax to a reservist. It is based on regulation 66 of SI 1993/744.

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90. The regulation reflects the non-cumulative nature of the scheme by prohibiting the Ministry from making a repayment.

91. Regulation 66(3) of SI 1993/744 lists the matters that the inspector should have regard to in deciding whether to make a repayment. Regulation 66(3)(c) of SI 1993/744 requires the Inland Revenue to have regard to “his income for the year from all other sources” when considering whether a repayment is due. As with the determinations under regulation 62 (see above) it is not clear that this is to include income other than PAYE income. But the legislation has been interpreted on that basis since 1975. This draft regulation makes this clear but – as with draft regulation 62 – provides for a reservist to object to non-PAYE income being taken into account. However it is thought that few if any such objections are likely to be made in practice as they might result in what could prove to be excessive repayments leading the reservist to have to pay tax in a lump sum after the end of the year. This change (*Change 12*) brings the regulation into line with practice while preserving reservists’ rights to object to non-PAYE income being taken into account.

Q13. We welcome comments on the proposal to make clear non-PAYE income can be taken into account in calculating any repayment unless the reservist objects. (*Change 12 in regulation 66*).

Regulation 67: Ministry to keep records

92. This regulation requires the Ministry to keep records of pay and tax deducted. It is based on regulation 67 of SI 1993/744.

93. In paragraph (2) of regulation 67 items (a)–(c) have been added to bring the regulation into line with draft regulation 38(2), and provide the Ministry with the information to enable it to comply with regulation 68. This is a change in the law (*Change 13*) but not in practice.

Q14. We welcome comments on the proposal to require the reservist’s name, national insurance number, and the tax year to which the deductions working sheet relates. (*Change 13 in regulation 67(2)(a)–(c)*)

Regulation 68: End of year certificate

94. This regulation requires that the Ministry give the reservist a certificate of tax deducted within 56 days of the year end. It is based on regulation 68 of SI 1993/744.

95. Paragraph (1) refers to “31st May” instead of “56 days after the end of the year” for clarity.

96. The regulation includes a minor change to bring it into line with, for example, draft regulations 39, and 57A. The change is to require the reservist’s NINO to be included. This (*Change 14*) is a change in the law. It is a tentative suggestion pending confirmation from the Ministry that either it is already its practice to include the

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reservist's national insurance number, or that its absence does not cause any practical difficulty, and that, if the Ministry does see the proposed change as desirable, it will be able to implement it.

Q15. We welcome comments on the proposal to require the reservist's national insurance number in the end of year certificate. (Change 14 in regulation 68(2))

97. This draft regulation does not yet incorporate a further change (*Change 15*) we propose to make, namely that an end of year certificate be issued whether tax has been deducted or not. The current regulation is triggered if a person is a reservist on the last day of the tax year, has not been given a certificate under regulation 65 for each payment of reserve pay, but has had tax deducted from that pay. If there has been no deduction of tax because of a determination under regulation 62 the reservist may have received no certificate under either regulation 65 or regulation 68. This could put the reservist at a disadvantage given the new emphasis on proof of income for tax credits, and also make it more difficult to meet the requirements for self-assessment. This change will rectify this. A similar change will be proposed for regulation 39, which again is currently triggered only when tax has been deducted.

Q16. We welcome comments on the proposal to require an end of year certificate whether or not tax has been deducted, and to make a similar change to regulation 39. (Change 15 in regulation 68(3))

Regulation 70: Other emoluments of reservist

98. This regulation makes it clear that nothing in this Chapter affects the application of PAYE to any other income of a reservist. It is based on part of regulation 70 of SI 1993/744.

Chapter 4: Holiday pay funds

Overview

99. This Chapter provides a simplified form of PAYE for payments made by holiday pay funds. The fund is required to deduct tax at the basic rate.

100. Regulation 71 defines the payments to which this scheme applies and other terms used in the regulations. Regulation 72 provides that the normal provisions for deductions, P45s, P46s and so on do not apply. Regulation 73 requires basic rate tax to be deducted from payments, and regulation 74 requires the fund to give a certificate showing the pay and tax deducted.

101. Regulation 75 provides for repayments by the Inland Revenue during a tax year.

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102. Regulation 76 requires a deductions working sheet for each recipient, and Regulation 78 makes clear none of this affects the operation of PAYE on a recipient's other PAYE income.

Background

103. These regulations deal with holiday pay in special holiday pay schemes. Such schemes are traditionally found in the construction and allied industries, and act as a savings scheme for holidays. Each week the employer buys a stamp from a fund on account of holiday pay for an employee. When the time for the holiday comes, the employer pays holiday pay to the employee. He then reclaims pay from the fund in return for the stamps. The employer does not have to account for PAYE tax on holiday pay stamps purchased, but the employee is liable to tax when the money is paid out from the fund. The fund is independent of the employer; payments from the fund are not from the employer, so special regulations were made to provide for deduction of tax at basic rate. These regulations are only concerned with holiday pay funds, not holiday pay in general. The heading of the chapter makes this clearer.

Regulation 71: Interpretation of Chapter 4

104. This regulation contains definitions for the purposes of this Chapter. It is based on regulation 71 of SI 1993/744.

105. The proviso that these definitions apply “unless the context otherwise applies,” has been omitted as unnecessary - there is nowhere that the context does require any other meaning.

106. The modifications to the meaning of “fund” as regards holiday pay for an employee who dies have been extracted and shown separately in paragraph (2).

Regulation 72: Application of other parts

107. This regulation disapplies Parts 3 and 4 of the regulations for payments by holiday pay funds. It is based on regulation 72 of SI 1993/744.

108. The disapplication in 72(1) implies that the remainder of the regulations apply, so the reference to Parts V and VIII applying with any necessary modifications in (old) regulation 77 has been dropped. Also, it will no longer be necessary to apply those regulations with modifications if the deduction of tax at basic rate is treated as if a basic rate code had been issued; it removes any difficulty in interpreting “appropriate code” in Part V, for example. (See regulation 62 where the same issue arises.)

Regulation 73: Deduction of tax

109. This regulation provides that a fund, on making a payment of holiday pay, must deduct income tax at the basic rate in force at the time the payment is made. It is based on regulation 73 of SI 1993/744.

These notes refer to the DRAFT PAYE regulations as at 7 January 2003

Regulation 74: Certificate of tax deducted

110. This regulation provides that a fund, on making a payment of holiday pay, shall give the recipient a certificate of tax deducted. It is based on regulation 74 of SI 1993/744.

111. The certificate is now required to show the recipient's national insurance number. This change (*Change 16*) brings the regulation into line with practice, as well as with regulation 39.

Q17. We welcome comments on the proposal to require the employee's national insurance number on certificates of tax deducted. (*Change 16*) in regulation 74)

Regulation 75: Repayment to recipient during year

112. This regulation deals with in-year repayment to the employee. It is based on regulation 75 of SI 1993/744.

113. All income is to be taken into account in considering whether a repayment is due, including income from all other sources such as non-PAYE income, "unless the recipient objects". This is a change (*Change 17*) in the law but not in practice. (See the explanation prior to Q10 on regulation 62.)

Q18. We welcome comments on the proposal to allow the recipient of holiday pay to object to non-PAYE income being taken into account in calculating any repayment. (*Change 17*) in regulation 75)

Regulation 76: Fund records

114. This regulation requires a fund to record on a deductions working sheet certain details. It is based on regulation 76 of SI 1993/744.

115. Part 5 of the regulations apply so the fund is required to make an end of year return on a P35, but because Part 4 does not apply there is no P14/P60 procedure. Instead, a modified deductions working sheet is required by regulation 76. This draft regulation requires that this should show the recipient's national insurance number. This is a change in the law (*Change 18*) but not in practice. It brings the regulation into line with regulation 38.

Q19. We welcome comments on the proposal to require the employee's national insurance number. (*Change 18*) in regulation 76)

Regulation 78: Other emoluments of recipient

116. This regulation states that nothing in this Chapter shall affect anything else in these regulations applying to any other emoluments of a recipient. It is based on regulation 78 of SI 1993/744. It is similar to regulation 70.

SUMMARY OF QUESTIONS IN THE COMMENTARY

- Q1. We welcome comments on the proposal to replace references to “inspector” by “the Inland Revenue” – defined to mean an officer of the Board. (*Change 1*).....5
- Q2. We welcome comments on the proposal to apply only regulation 79A where there is a succession to an intermediary. (*Change 2 in regulation 80*)7
- Q3. We welcome comments on the proposal to make explicit who, on the death of an employer or succession to a business, is to account for tax in respect of notional payments. (*Change 3 in regulations 79 and 80*)8
- Q4. We welcome comments on the proposal to extend the option offered by this Chapter beyond attendance allowance to the other allowances. (*Change 4 in regulation 56(1)*)10
- Q5. We welcome comments on whether Chapter 2 should apply to the expenses payments in the same way as other allowances.11
- Q6. We welcome comments on the proposal to require the councillor’s national insurance number and name on the deductions working sheet. (*Change 5 in regulation 57A*)12
- Q7. We welcome comments on the proposal to treat the option for basic rate as if a basic rate code had been issued. (*Change 6 in regulation 58*)12
- Q8. We welcome comments on the proposal to remove officers of the retired and emergency lists of the Royal Navy and Royal Marines, and officers of the Regular Army Reserve of Officers from the scope of this regulation. (*Change 7 in regulation 59(2)*).13
- Q9. We welcome comments on the proposal to apply the rest of these regulations as if a basic rate code had been issued. (*Change 8 in regulation 60*).14
- Q10. We welcome comments on the proposal to make clear that non-PAYE income can be taken into account when determining whether tax at basic rate is to be deducted from reserve pay, and to give reservists a right to object to such income being taken into account. (*Change 9 in regulation 62*)15
- Q11. We welcome comments on the proposal to provide for all appeals to be to the General Commissioners. (*Change 10 in regulation 63A*)16
- Q12. We welcome comments on the proposal to make explicit that the rules in Schedule 3 to TMA 1970 may be applied in respect of appeals made against a determination to deduct tax at the basic rate from reservists’ pay. (*Change 11 in regulation 63B*)16

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- Q13. We welcome comments on the proposal to make clear non-PAYE income can be taken into account in calculating any repayment unless the reservist objects. *(Change 12 in regulation 66)*.17
- Q14. We welcome comments on the proposal to require the reservist’s name, national insurance number, and the tax year to which the deductions working sheet relates. *(Change 13 in regulation 67(2)(a)-(c))*.....17
- Q15. We welcome comments on the proposal to require the reservist’s national insurance number in the end of year certificate. *(Change 14 in regulation 68(2))*..18
- Q16. We welcome comments on the proposal to require an end of year certificate whether or not tax has been deducted, and to make a similar change to regulation 39. *(Change 15 in regulation 68(3))*18
- Q17. We welcome comments on the proposal to require the employee’s national insurance number on certificates of tax deducted. *(Change 16] in regulation 74)*..20
- Q18. We welcome comments on the proposal to allow the recipient of holiday pay to object to non-PAYE income being taken into account in calculating any repayment. *(Change 17 in regulation 75)*20
- Q19. We welcome comments on the proposal to require the employee’s national insurance number. *(Change 18 in regulation 76)*20