

These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.

## PAYE REGULATIONS

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### EXPLANATORY NOTES

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

<i><b>Draft Regulation</b></i>	<i><b>Heading</b></i>	<i><b>Based on Regulation</b></i>
101A	Adjusting tax deducted in a year for purposes of sections 59A(1) and 59B(1) TMA	101A(1),(2),(4)
101B	Recovery: adjustment of employee's code	101A(3), (new)
101	Assessments other than self-assessments	101(2),(3),(4),(6) and (7)
102	Provisions for direct collection and special arrangements	102
104	Direct collection	104(1) to (4), (14),(15) and (new)
104A	Direct collection: failure to pay	104(5),(6)
104B	Direct collection: return on ceasing to receive [PAYE income]	104(9),(10)
104C	Direct collection: end of year return	104(11),(12),(13) and (16)

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**GLOSSARY**

ICTA	the Income and Corporation Taxes Act 1988
PAYE	Pay As You Earn
PAYE income	as defined by clause 683 of the Bill (equivalent to Schedule E income)
the Bill	the Income Tax (Earnings and Pensions) Bill as introduced in the House of Commons on 5 December 2002 [Bill 13]
TMA	the Taxes Management Act 1970

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## **PART 8: ASSESSMENT AND DIRECT COLLECTION**

### ***Overview***

1. This Part deals with:
  - adjustments, for self assessment purposes, to the amount of income tax deducted from a person under PAYE. The amount deducted, adjusted as necessary, is fed through to the calculations in sections 59A(1) and 59B(1) of TMA. Those TMA calculations relate to payments, and recoveries, by that person under self assessment (draft regulation 101A);
  - “coding adjustments” to collect the balance of a person’s self-assessment tax liability. Which means that the PAYE system effectively collects the underpayment from the person in a later tax year (draft regulation 101B);
  - cases where the Inland Revenue assess a person’s tax liability on PAYE income. It allows tax deducted under PAYE to be offset against the person’s liability under the assessment. For this purpose, adjustments may also be needed to the amount of income tax actually deducted under PAYE. (draft regulation 101); and
  - arrangements, in certain cases, for collecting tax other than by the normal system of the employer deducting tax by reference to tax tables (draft regulations 102 to 104C).
2. The numbers used for the draft regulations are provisional. For the most part those provisional numbers are the same as, or similar to, numbers used by corresponding material in Part VIII of SI 1993/744.
3. These draft regulations have been reordered and reorganised in minor respects within Part 8. They may be reordered again, or even put into separate Parts, when a full draft of the PAYE regulations is issued for formal consultation in 2003.
4. These draft regulations mainly propose:
  - to omit some regulations currently in Part VIII of SI 1993/744; and
  - changes that more clearly reflect the impact of self assessment.
5. Paragraphs 6 to 9 highlight two developments that are significant in explaining many of these proposals. Paragraphs 13 to 33 explain the proposals to omit some regulations in SI 1993/744. The commentary on the draft regulations from paragraph 34 onwards explains the changes that are proposed.

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***Two developments since the first set of PAYE regulations with particular relevance to this Part***

6. The first PAYE regulations, SI 1944/251, became effective almost 60 years ago. The way in which those first PAYE regulations were expressed naturally reflected the tax system then prevailing. In particular the fact that:

- the “main system” for assessing income involved assessors and general commissioners. But, as an exception to the “main system”, the Inland Revenue could prepare assessments to income tax under Schedule E. The first PAYE regulations dealt with two aspects of this exception. First, with making Schedule E assessments. Second, with various matters related to Schedule E assessments. Such related matters included appeal rights and how and when to deal with tax shown as payable or repayable under Schedule E assessments; and
- assessments were made on a schedular basis. A person could, and often did, receive more than one assessment for a tax year.

7. The first relevant development was in the Income Tax Management Act 1964. That ended the earlier “main system” involving assessors and general commissioners. From tax year 1965/66, the Inland Revenue made most assessments. The making of Schedule E assessments and associated administrative provisions that were common to other assessments were therefore all dealt with in the Income Tax Management Act 1964.

8. The PAYE regulations were adapted from tax year 1965/66 as they then needed to deal only with areas where differences existed with other assessments — such as how, and when, to deal with tax payable or repayable under Schedule E assessments.

9. The second relevant development was the arrival of self assessment for income tax from tax year 1996/97. Self assessment:

- made individuals, rather than the Inland Revenue, primarily responsible for assessing their income and capital gains tax liabilities, and
- ended the system of separate, schedular assessments for income tax.

10. Self assessment therefore meant that the material in the PAYE regulations relating to Schedule E assessments needed to be adapted.

11. A rewrite of Part VIII of SI 1993/744, consisting of regulations 99 to 108, provides the opportunity to deal with certain lingering aspects of Part VIII that can only be fully understood by readers who are familiar with the PAYE system prior to these adaptations.

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12. In particular there now seems to be no need for the following regulations presently in Part VIII of SI 1993/744:

- Regulation 99;
- Regulation 105; and
- Regulations 106 to 108.

Note that Regulations 100 and 103 were revoked, from 5 June 1996, by regulation 19 of SI 1996/1312 except in relation to assessments for tax years 1995/96 or earlier.

***Omitting regulation 99 (Assessment) of SI 1993/744***

13. Regulation 99 of SI 1993/744 says:

Nothing in these Regulations shall prevent an assessment (whether made under section 9 of the Management Act or otherwise) being made in respect of income assessable to income tax for any year.

14. Someone reading regulation 99 may instinctively look for another regulation that could prevent an assessment being made. And then wonder why it is difficult to find that other regulation. The history of this regulation suggests that it is not needed. And the risk of it causing confusion suggests that regulation 99 should be omitted.

15. The origins of regulation 99 of SI 1993/744 can be traced back to regulation 42 of SI 1944/251 which, see the first bullet of paragraph 6, said:

(1) Income tax in respect of emoluments **shall be assessed and charged by the Inspector**, who for that purpose may exercise all the powers of an assessor and of any commissioners ... (our emphasis)

16. That remained essentially unchanged until 1965. Then, see paragraph 7, Regulation 49 of SI 1965/516 omitted references to emoluments being assessed by an inspector. Instead, regulation 49 of SI 1965/516 started:

(1) **The assessment** of emoluments **shall be made pursuant to** the provisions of **section 5 of the Income Tax Management Act 1964**. ... (our emphasis)

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17. And that form of wording continued up to and including the 1993 consolidation of the Regulations. So Regulation 99 of SI 1993/744 originally said:

(1) Nothing in these Regulations shall prevent an assessment under Schedule E being made on a person in respect of his emoluments.

(2) The assessment of emoluments shall be made in accordance with section 29 of the Management Act. ...

Section 29 of the Management Act was the provision that required the Inland Revenue to make assessments for tax years prior to 1996/97, see paragraph 9 and 10.

18. Regulation 99(2) of SI 1993/744 was the substantive provision that was consolidated in 1993. Regulation 99(1) was drafting introduced in 1993 and modelled on what was then section 205(3) ICTA.

19. Regulation 99(2) of SI 1993/744 was omitted and regulation 99(1) of SI 1993/744 adapted for self assessment, see paragraph 10, by Regulation 13 of SI 1996/1312; so regulation 99 of SI 1993/744 was altered to read:

Nothing in these Regulations shall prevent an assessment (whether made under section 9 of the Management Act or otherwise) being made in respect of income assessable to income tax for any year.

20. Thus SI 1996/1312 removed the substantive provision of regulation 99(2) of SI 1993/744 because that related to Schedule E assessments being made. But SI 1996/1312 left in place (and adapted) drafting that was introduced just three years earlier in relation to the substantive provision which was being removed.

21. Regulation 99 of SI 1993/744 is not needed. The Bill omits the part of section 205 ICTA on which this regulation is based as it is also not needed under self-assessment (see note 62 in Annex 2 to the Explanatory Notes to the Bill). And what is left in regulation 99 of SI 1993/744 could be confusing.

***Omitting regulation 105 (Recovery of tax from employee) of SI 1993/744***

22. Regulation 105 of SI 1993/744 says:

(1) Any tax which is payable to the collector by any employee may be recovered in the manner provided by the Income Tax Acts.

23. A reader might think that those words relate, say, to tax that is expressed to be “recovered from the employee” by regulation 42(2) or (3) or regulation 49(5) of SI 1993/744. That would be wrong. The history of this regulation suggests that it is not needed. And the risk of it causing confusion suggests that regulation 105 should be omitted.

24. The origins of regulation 105 of SI 1993/744 can be traced back to regulation 48 of SI 1944/251 which, see the first bullet of paragraph 6, said:

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(1) Any tax which is payable to the Collector by any employee may be recovered in the manner provided by the Income Tax Acts.

(2) Any tax which is payable to the Collector under paragraph (2) of regulation 46, or under any additional assessment made under paragraph (9) of regulation 47, shall be payable within fourteen days of the date on which the Collector first makes application for payment thereof.

The references to regulations 46(2) and 47(9) of SI 1944/251 concerned underpayments shown in Schedule E assessments made under regulation 42 of SI 1944/251 (see paragraph 15).

25. This material from regulation 48 of SI 1944/251 has remained essentially unchanged through successive consolidations of the PAYE regulations up to and including its becoming regulation 105 of SI 1993/744.

26. Regulation 48 of SI 1944/251 was clearly referring to the tax shown as payable in a Schedule E assessment made under the PAYE regulations. The “successors” to regulation 48 of SI 1944/251 were, from 1965/66, clearly referring to Schedule E assessments made under primary legislation (see paragraph 16).

27. Regulation 105(2) of SI 1993/744 was revoked by regulation 18 of SI 1996/1312 in relation to tax years from 1996/97. There was clearly no point in giving a date for payment of Schedule E tax after Schedule E assessments stopped being made.

28. It may have been overlooked that regulation 105(1) related to amounts shown as payable by a Schedule E assessment and that regulation 103, which also provided for Schedule E assessments, was being revoked from 1996/97 onwards. So there was a good case for revoking regulation 105(1) from 1996/97 in the same way as done for regulation 105(2).

29. In any case, assessments of emoluments are now made under TMA and the recovery provisions of TMA will apply to such assessments without any assistance from regulation 105(1) of SI 1993/744.

***Omitting regulations 106 to 108 of SI 1993/744***

30. Regulations 106 to 108 of SI 1993/744 deal, in a limited number of cases, with repayments of income tax resulting from a Schedule E assessment for a tax year. They apply where the repayment of income tax takes account of overpayments or underpayments of tax for earlier tax years.

31. Those regulations attribute, as envisaged by section 824(5) of ICTA, the overpayment to various tax years. That attribution is for the purpose of calculating repayment supplement due under section 824 ICTA.

32. Section 196 and paragraph 41(3) of Schedule 19 to FA 1994 repealed section 824(5) ICTA from the tax year 1996/97. So, regulation 106 of SI 1993/744 (and

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regulations 107 to 108 which supplement it) has no application to current or future tax years.

33. We therefore propose not to rewrite regulations 106 to 108 of SI 1993/744. We will consider whether a transitional provision is needed to cover the possibility that a repayment of income tax may be made after 5 April 2004 and which is consequential on a Schedule E assessment made for tax year 1995/96 or earlier.

### **Heading of this Part**

34. The word “assessment” has been in the title of this Part since the first PAYE regulations, SI 1944/251, which actually provided for assessments to be made. Following the two relevant developments in 1965/66 and 1996/97 it might be appropriate to adapt the word “assessment” to better reflect what this Part currently does. The words “direct collection” have been in the title from the first consolidation of the PAYE regulations, SI 1950/453. If the heading is reconsidered in relation to “assessment”, it might be appropriate to consider whether the heading can also refer to something more meaningful than just “direct collection”. That could lead to a heading on the lines of, say, “Employees’ tax”.

35. But as there may also be a case for moving some regulations to other Parts this draft has not changed the heading.

### **Regulation 101A: Adjusting tax deducted in a year for purposes of sections 59A(1) and 59B(1) TMA**

36. This regulation adjusts the amount of tax deducted at source under PAYE that is fed into the calculations in sections 59A and 59B of TMA. It is based on paragraphs (1), (2) and (4) of regulation 101A of SI 1993/744, which was inserted by regulation 15 of SI 1996/1312. Part of it is new.

37. Section 59B of TMA concerns the balance (taking account of tax deducted at source or paid on account) of tax for a tax year that remains payable by, or is repayable to, a taxpayer under a self-assessment.

38. Section 59A of TMA concerns whether payments on account of income tax must be made for a tax year (based on the circumstances of the previous tax year) and, if so, how much.

39. *Paragraph (1)* gives the purposes for which the regulation applies.

40. *Paragraph (2)* explains that later paragraphs adjust the amount of tax actually deducted under PAYE in the tax year.

41. *Paragraph (3)* ensures that relief is not given for so much of any tax deducted as has in fact been repaid.

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42. *Paragraph (4)* ensures that coding adjustments in the current year, which are intended to repay overpayments of tax from an earlier year, are not effectively reversed. That is done by, broadly, allowing an offset against the current years tax liability for the (greater amount of) tax that would have been deducted if a coding adjustment had not been made for the earlier year's overpayment.

43. *Paragraph (5)* adds tax that was not actually deducted under PAYE but should have been. There are restrictions. This addition must not lead to a repayment of the tax that was not actually deducted. And there is no addition in the case of tax, not actually deducted, which is the subject of a formal direction by the Inland Revenue.

44. *Paragraph (6)* contains definitions. The definition of "direction tax" refers to working draft regulations, as at 16 July 2002, in Annex B of paper SC/CC(02)11.

### **Background**

45. Regulation 101 of SI 1993/744 concerns the Inland Revenue making what is essentially a Schedule E assessment. With the arrival of self assessment from tax year 1996/97, routine Schedule E assessments by the Inland Revenue were eliminated and regulation 101 became largely redundant. Regulation 101A of SI 1993/744 was therefore inserted to deal with certain aspects of the interaction between PAYE and self assessment.

46. A taxpayer's self-assessment is essentially a single assessment of capital gains tax and of income tax on different types of income. An appropriate mechanism is therefore needed to deal with any tax already paid which relates to items included in the assessment; in particular the tax deducted at source under PAYE needs to feed into that mechanism. Section 59B(1)(b) and (2) of TMA contains the mechanism by which PAYE deducted at source is set off against the tax shown in the self-assessment. Section 59B(8) of TMA allows the PAYE regulations to make further adjustments, for the purposes of section 59B, to the amount of PAYE deducted at source in a tax year.

47. This regulation essentially adjusts the figure of tax deducted at source under PAYE to:

- subtract so much, if any, of that tax which has already been repaid outside of the self assessment framework
- add back prior year overpayments of tax reflected in the taxpayer's code for the current year; and
- add, subject to conditions, tax that should have been, but was not, deducted under PAYE by the payer.

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***Decompression***

48. In the circumstances described in regulation 101(4), Regulation 101A(1) and (2)(b) of SI 1993/744 modifies the tax deducted at source under PAYE where “necessary”. But in SI 1993/744 it is difficult to see what is “necessary”.

49. By contrast, this regulation sets out more clearly, and in separate paragraphs, the adjustments that are made to the amount of tax deducted at source under PAYE.

***Omission of some of the words in regulation 101A(4) of SI 1993/744.***

50. Paragraph (3) omits the words “in the year in which the tax was deducted at source, or after the end of that year but” which are in regulation 101A(4) of SI 1993/744. They are not needed because tax is not going to be repaid before the year in which it is deducted. And the shorter form of words covers the possibility that the tax was repaid either in the same year as it was deducted or in a later year.

***The adjustments in regulation 101(4)(b),(c) and (d) of SI 1993/744 are not required in regulation 101A of SI 1993/744 or this regulation***

51. Two of the adjustments corresponding to those in regulation 101(4) of SI 1993/744 are dealt with by section 59B(2)(a) of TMA (and, correspondingly, in section 59A(8) of TMA); they are therefore not “necessary” in this regulation. Those are the coding adjustments that, outside of a self-assessment, are dealt with by regulation 101(4)(c) and (d). (See paragraphs 83 and 89)

52. Paragraph 100 sets out the reason why regulation 101(4)(b) of SI 1993/744 is no longer needed.

***Dealing with the possibility that overpayments may have been dealt with by a coding adjustment for a later year***

53. Overpayments of tax for a tax year will normally be repaid to a taxpayer. But it is possible that small overpayments for an earlier year will have been taken into account in an employee’s code for a later year. Paragraph 78 deals with a proposed rewrite change — that tax overpaid for a year may be repaid under PAYE by making coding adjustments for a later year.

54. Paragraph (4) of this regulation is a change that is consequential on that proposed rewrite change. It adds the amount of tax overpaid in the earlier year (to the extent that it is reflected in a coding adjustment for the later year) to the tax actually deducted under PAYE in the later year.

55. This adjustment ensures that the overall tax payable for the later year is not affected by a decision to repay tax, for the earlier year, under PAYE in a later year. Without this adjustment the taxpayer would get no benefit from the earlier year’s overpayment being repaid under PAYE in the later year. This is because the “balance” of tax payable after the end of the later year would otherwise simply increase by the same amount as PAYE deductions had been reduced during that later year.

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**Q1. Regulation 101A(4) We welcome comments on the proposed (consequential) rewrite change to add, for self assessment purposes, amounts of tax overpaid in the earlier year (to the extent reflected in a coding adjustment for the later year) to the tax actually deducted under PAYE in that later year.**

***Bringing into this regulation the adjustments currently dealt with in a mixture of regulation 101A and regulation 101(4)(a), (5) and (6) of SI 1993/744.***

56. The material brought together in paragraph (5) means that it is no longer necessary to untangle and adapt material from a separate regulation (as regulation 101A(2)(b) of SI 1993/744 currently requires).

***The cap on credit for tax that was not deducted (but should have been)***

57. Regulation 101(5) of SI 1993/744 restricts the credit for tax that should have been deducted under PAYE but was not deducted (“notional tax”). That restriction ensures notional tax is not repaid to the employee. Regulation 101(5) *broadly* operates by limiting notional tax to:

Assessed tax liability on PAYE income — actual PAYE deductions.

58. Thus there is effectively a “cap” on the credit for notional tax under regulation 101 of SI 1993/744; equal to the gross liability on the PAYE income minus deductions at source from that PAYE income.

59. The explicit reference in regulation 101A(2)(b) of SI 1993/744 to regulation 101(5) makes it clear that there is a cap on notional credit under self assessment. But a self-assessment does not have, or need, a figure for assessed tax liability on PAYE income. Nor are actual PAYE deductions the only matters taken into account in deciding what remains payable, or is repayable, following a self-assessment. That makes it difficult to say with certainty what the cap is under regulation 101A.

60. As different views could be taken of what “necessary adjustments” are intended, in the context of a cap on notional credit, by regulation 101A(1) of SI 1993/744 any explicit statement on the issue is open to dispute. But perpetuating the “necessary adjustments” approach is unhelpful to readers. For this reason, we propose a rewrite change to make explicit the calculation of the cap.

61. Some might argue that the same cap applies for regulation 101A of SI 1993/744 as applies for regulation 101 of SI 1993/744 (see paragraph 58). But that would involve additional calculations to find, at least, the “assessed tax liability on PAYE income”. And there might not be agreement on how those calculations should be done.

62. Others might argue that the cap is to be found by looking at what would otherwise be payable under section 59B(1) of TMA. That does not involve the sort of

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additional calculations mentioned in the previous paragraph. And it ought to raise the cap because tax attributable to capital gains and non-PAYE income will be included in what a taxpayer must pay and this extra tax will, *in most cases*, exceed the tax deducted at source from non-PAYE income. But the calculation in section 59B(1) TMA also reduces the cap to the extent that payments on account are made in respect of the year and this reduction for payments on account seems arbitrary.

63. The alternatives mentioned in paragraph 61 and 62, or others, to setting an explicit cap on notional credit are not entirely satisfactory. Paragraph (5) of this regulation uses a variant of the alternative mentioned in paragraph 62 — it adds back any payments on account so that they do not reduce the cap on notional credit. That variation seems justifiable because there seems no reason for a taxpayer to be disadvantaged by having made payments on account.

64. Paragraph (5) *broadly* gives a cap equal to the self-assessment tax liability (on capital gains and any income) less tax deducted at source.

65. That seems a relatively generous interpretation of the “cap” that should apply on notional tax, which should in principle, be favourable to most taxpayers. But one which is likely to have to have little impact in practice because taxpayers who might be subject to the cap on notional credit are unlikely to have, say, significant capital gains tax liabilities.

66. The cap in paragraph (5) has the advantage of simplicity; certainly when compared to the alternative mentioned in the first bullet of paragraph 60.

**Q2. Regulation 101A We welcome comments on the proposed rewrite change to include in this regulation an explicit calculation of the “cap” on notional credit. We also welcome comments on the proposed explicit cap in paragraph (5) of this regulation.**

**Regulation 101B: Recovery: adjustment of employee’s code**

67. This regulation deals with the Inland Revenue collecting an underpayment, calculated under section 59B(1) of TMA, through PAYE (by making a coding adjustment for a later year instead of collecting that underpayment directly). It is based on regulation 101A(3) of SI 1993/744 but includes changes.

68. *Paragraph (1)* allows underpayments from a self-assessment to be collected under PAYE by a coding adjustment for a later year, subject to conditions.

69. *Paragraphs (2) to (5)* set out the conditions for underpayments from a self-assessment to be collected under PAYE. They are new and reflect current practice.

70. *Paragraph (6)* allows an overpayment from a self-assessment to be repaid under PAYE, unless the taxpayer objects.

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***Is there power to code out self-assessment underpayments?***

71. The power to make PAYE regulations in section 203 ICTA is largely expressed in terms of income assessable to income tax under Schedule E (“PAYE income”) and the income tax payable in respect of such income. Those powers seem to cover the adjustments set out in regulation 101 of SI 1993/744 – which relates to assessments of PAYE income.

72. There is however a tension between first, powers that refer to income tax assessable on PAYE income and second, a self-assessment which arrives at tax liabilities on the capital gains and all of the income of a person.

73. That tension is recognised by sections 59A(10) and 59B(8) of TMA. They allow the PAYE regulations to adjust, for the purposes of sections 59A(1) and 59B(1) of TMA, the amount of tax deducted under PAYE. Such adjustments are dealt with in regulation 101A.

74. Subject to certain conditions, self-assessment underpayments arrived at under section 59B(1) of TMA are collected under PAYE by a coding adjustment for a later year. People whose underpayments are collected in this way generally welcome such treatment because it collects that tax in instalments. It appears that section 59B(2)(b) of TMA envisages self-assessment underpayments being collected under PAYE. But there does not seem to be a power permitting the practice of collecting under PAYE an underpayment of tax that does not relate solely to Schedule E income.

75. The project exposed to interested parties a proposal for changes to the primary legislation in 2002 that would have dealt with this issue, and others. That proposal was withdrawn in light of a desire, on the part of those consulted, to see what form the rewritten regulations would take before accepting the proposal. The Inland Revenue will discuss possible changes to the primary legislation in 2003 to deal with this issue, and others. Whether those changes will be proposed in a future Finance Bill is of course a matter for Ministers; and it would then be for Parliament to decide if they should be enacted. But, in order to show better how any changes would be followed through to the PAYE regulations, this draft regulation provides for self-assessment underpayments to be collected under PAYE even where the underpayments may not relate to Schedule E income.

***Eliminating regulation 101A(3)(a) of SI 1993/744 as unnecessary***

76. Regulation 101A(3)(a) of SI 1993/744 is essentially based on regulation 101(2) of SI 1993/744. It does not seem to take into account that tax calculated as payable under section 59B will automatically be payable in the absence of action to collect the tax under PAYE. Regulation 101A(3)(a) is therefore unnecessary and we propose not to rewrite it.

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***Which underpayments are collected under PAYE***

77. Paragraphs (2) to (5) of this regulation are new. They reflect the current practice on collecting self-assessment underpayments by making coding adjustments for a later year.

**Q3. Regulation 101B(2) to (5) We welcome comments on the proposed rewrite change for the regulations to reflect practice on coding adjustments to collect underpayments.**

***Overpayments***

78. Paragraph (6) of this regulation is new. It allows tax overpaid for an earlier year to be refunded, by a suitable coding adjustment, under PAYE – *if the taxpayer does not object*. This reflects what sometimes happens in practice. Section 203 of ICTA and regulation 7 of SI 1993/744 provide for the overpayment of tax in respect of Schedule E income. But section 59B of TMA does not give power for such a coding adjustment to be made for overpayments in respect of other income. See paragraphs 74 and 75, which discuss (in the context of coding adjustments for underpayments of tax) the additional powers that are needed if this proposed rewrite change on overpayments is to be made.

79. Regulation 101A(4) ensures that section 59B(1) of TMA will not deprive the taxpayer of the benefit of repayments of earlier year's tax being made in this way (see paragraph 54).

**Q4. Regulation 101B(6) We welcome comments on the proposed rewrite change to permit, subject to a taxpayer's right to object, overpayments of tax for a year to be refunded by making coding adjustments in a later year.**

**Regulation 101: Assessments other than self-assessments**

80. This regulation deals with tax charged on PAYE income in an assessment that is not a self-assessment. It is based on regulation 101(2) to (4), (6) and (7) of SI 1993/744.

81. This regulation reduces the tax assessed for the year on PAYE income by tax deducted under PAYE during that year. For this purpose, the tax deducted under PAYE is itself adjusted in certain cases.

82. *Paragraph (1)* makes clear that this regulation does not apply in relation to self-assessments.

83. *Paragraphs (2) and (3)* set out the calculation of tax that the person assessed still has to pay and various adjustments that may be needed, to the tax deducted under PAYE, in order to compute that underpayment.

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84. *Paragraphs (4) and (5)* deal with cases where the employee is prevented from treating amounts, not in fact suffered by the employee, as if they were tax paid by the employee. Those cases are ones where the Inland Revenue has formally directed that relief for such amounts is not available to the employee.

85. *Paragraph (6)* allows the underpayment to be collected by a coding adjustment for a later year.

86. *Paragraph (7)* supplements other paragraphs. The definition of “direction tax” refers to working draft regulations, as at 16 July 2002, in Annex B of paper SC/CC(02)11.

### **Background**

87. The origins of regulation 101 of SI 1993/744 go back to regulation 46 of the first PAYE regulations, SI 1944/251. Regulation 46 of SI 1944/251 related to assessments of Schedule E income (made by an inspector under the authority of regulation 42 of the first PAYE Regulations). It dealt with the way in which overpayments and underpayments resulting from such assessments could either be settled directly or alternatively under PAYE. Regulation 46 said:

(1) If the tax payable under the assessment is less than the total net tax deducted from the employee’s emoluments during the year, the Inspector may, and if the employee so requires shall, repay the difference to the employee instead of taking it into account in determining the appropriate code for a subsequent year.

(2) If the tax payable under the assessment exceeds the total net tax deducted from the employee’s emoluments during the year, the Inspector may require the employee to pay the excess to the Collector instead of taking it into account in determining the appropriate code for a subsequent year, and where the Inspector so requires the employee shall pay the excess accordingly.

(3) For the purposes of determining the amount of any difference or excess as aforesaid, any necessary adjustment shall be made to the aforesaid total net tax in respect of —

(a) any tax which the employer was liable to deduct from the employee’s emoluments but failed to deduct, having regard to whether the Commissioners of Inland Revenue have or have not directed that that tax shall be recovered from the employee; and

(b) any tax overpaid or remaining unpaid for any previous year...

88. That provision remained broadly unchanged through successive consolidations of the PAYE regulations until 1973. Regulation 49 of SI 1973/334 introduced a provision to prevent the PAYE regulations resulting in income tax being repaid to a person who had not paid the income tax in the first place. This 1973 change is the origin of regulation 101(5) of SI 1993/744.

89. There were later changes to what is now regulation 101 SI 1993/744. The changes dealt with adjustments to the tax deducted under PAYE mainly to:

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

- ensure that credit was not allowed against a later years tax liability for amounts deducted under PAYE in that later year but which represented the collection of an earlier years tax liability (in this case “excessive Schedule E overpayments” made to the employee for an earlier tax year) (regulation 101(4)(d) of SI 1993/744);
- stop an employee from having to pay tax, for which the employer was liable, in relation to certain payments made under a profit-related pay scheme; that occurred where such payments only became taxable as a result of a subsequent withdrawal of approval of the profit related pay scheme (regulation 101(4)(b) of SI 1993/744); and
- clarify that an employee cannot get credit for tax not suffered by the employee and in relation to which a direction is made under regulation 42 or 49 of SI 1993/744 that the tax be recovered from the employee (regulation 101(6) of SI 1993/744).

90. Finally regulation 14 of SI 1996/1312 made amendments to regulation 101 of SI 1993/744 to:

- remove the words “in respect of Schedule E” which had followed “an amount of tax” in regulation 101(4)(d); and
- add a new paragraph (7) to regulation 101.

91. The changes by SI 1996/1312 related to the arrival of self-assessment. The explanatory notes recorded that the regulations:

... remove or replace (as appropriate) references ... to assessments under Schedule E for the year 1996/97 and subsequent years ..., reflecting the fact that under self assessment, there is one calculation of tax liability based on income from all sources and capital gains

92. The changes made to regulation 101 of SI 1993/744 by SI 1996/1312 were necessary. But, as explained below, they should probably have gone further in relation to tax years from 1996/97.

***What assessments does regulation 101 of SI 1993/744 relate to from 1996/97 (when self-assessment for income tax applies)?***

93. From the first PAYE regulations, SI 1944/251, it seems clear that the assessment in question was a Schedule E one, on emoluments, which was then made under those first PAYE regulations. And, from tax year 1965/66 onwards, it seems clear that the assessment in question was a Schedule E assessment, on emoluments, made under what is now TMA.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

94. But, as noted in paragraph 91, under self assessment there is normally a self-assessment of tax based on all of a person's income and capital gains. And that case is specifically excluded from regulation 101 by regulation 101(7) of SI 1993/744.

95. This means that under self assessment, regulation 101 of SI 1993/744 seems capable of applying only to "discovery assessments" made by the Inland Revenue under section 29 of TMA. "Discovery assessments" under section 29 of TMA are ones to "make good to the Crown the loss of tax".

96. The scope of regulation 101 of SI 1993/744 is therefore very limited under self assessment.

***Omitting regulation 101(1) of SI 1993/744 and related material because it is redundant under self assessment***

97. As regulation 101 of SI 1993/744 seems only to apply to assessments intended to make good to the Crown a loss of tax, the assessments to which it applies will no longer lead to repayments of tax (as regulation 101(1) envisages).

98. It seems unhelpful, and potentially misleading, to rewrite a provision that will not apply for current and future years. So we propose not to rewrite regulation 101(1) of SI 1993/744. Nor, for the same reason, do we propose to rewrite material that relates in some way to tax being overpaid, namely:

- regulation 101(5); and
- references, in regulation 101(3), to paragraphs (1) and (5) of regulation 101.

***Omitting regulation 101(4)(b) of SI 1993/744***

99. Regulation 101(4)(b) relates to payments made under a profit related pay scheme that is registered under Chapter III of Part V of ICTA. The registration of such schemes came to an end by 31 December 2000 at the latest (section 61(3) of FA 1997).

100. The last tax year affected by this provision was 2000/2001. We therefore propose not to rewrite regulation 101(4)(b).

***Why bother rewriting any of the rest of regulation 101 of SI 1993/744?***

101. Regulation 101(4) of SI 1993/744 allows credit to be given to an employee for tax that should have been, but was not, deducted from payments of PAYE income that are included in a "discovery assessment" made under section 29 TMA.

***Discovery assessments***

102. We are aware that regulation 101 of SI 1993/744 might not cope well if an assessment under section 29 of TMA included both PAYE income and other income. But other income, if there were any, would be separately assessed. So there is no need to go further.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

**Regulation 102: Provisions for direct collection and special arrangements**

103. This regulation allows the Inland Revenue to make arrangements, not involving the employer deducting tax by reference to tax tables, to collect tax on PAYE income. It is based on regulation 102 of SI 1993/744.

104. The cases where the Inland Revenue may do this are first, casual employment and second, where the Inland Revenue are satisfied that it is impractical for the employer to deduct tax by reference to tax tables.

***Background***

105. An indication that special arrangements would be a feature of PAYE was flagged in the 1943 White Paper that preceded the introduction of PAYE. That White Paper, “A new system for the taxation of weekly wage earners” [Cmd 6469], said at paragraph 21:

... In the case of certain kinds of casual workers, however, where in any week there may be part-time work for several employers, e.g. part-time gardeners, it may not be practicable to apply the new system and special arrangements will have to be made.

106. This regulation has its origin in regulation 47(1) of the first PAYE regulations, SI 1944/251:

(1) In cases of casual employment, and in any other class of case in which the Commissioners of Inland Revenue are of the opinion that the deduction of tax by reference to the tax tables is impracticable, those Commissioners may make special arrangements for the collection of the tax in respect of any emoluments, and may in particular direct that the following provisions of this Regulation shall apply.

The following provisions of regulation 47 related to assessing the employee on a provisional basis during the year with adjustments in due course.

107. And Regulation 2 of SI 1944/1015 “amplified” Regulation 47 by adding a new Regulation 47A into SI 1944/251:

(1) In any case falling within paragraph (1) of Regulation 47, the Inspector, instead of making an assessment under paragraph (2) of that Regulation, may issue a tax deduction card to the employee ...

The rest of regulation 47A dealt with a procedure under which the employee broadly operated a form of PAYE on payments received by the employee.

108. Those provisions remained essentially the same through successive consolidations of the PAYE regulations up to and including their becoming regulation 102 of SI 1993/744.

109. Regulation 16 of SI 1996/1312 omitted regulation 102(2)(a) of SI 1993/744 for tax years 1996/97 onwards. That was because regulation 102(2)(a) pointed to regulation 103 of SI 1993/744 which was concerned with Schedule E assessments and self assessment did away with such assessments. And, for the same reason,

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

Regulation 19 of SI 1996/1312 revoked Regulation 103 of SI 1993/744 for tax years from 1996/97

***Arrangements made under regulation 102 of SI 1993/744***

110. The sorts of arrangements that are made under regulation 102 are set out in Part 8 of the Inland Revenue's manual on Employment Procedure. They cover diverse matters such as payments to examiners and students.

**Regulation 104: Direct Collection**

111. This regulation provides for employees to operate PAYE on their PAYE income. It is based on regulation 104(1) to (4), (14) and (15) of SI 1993/744.

112. With the next three regulations this provides that the employee must make quarterly income tax payments, and the necessary returns, to the Inland Revenue much like any small employer. All four regulations are based on regulation 104 of SI 1993/744 but with changes.

113. *Paragraph (1)* sets out when this regulation applies.

114. *Paragraph (2)* gives the employee the ability to stop this, and the following three regulations, from applying.

115. *Paragraphs (3) to (5)* deal with what the employee must record on receiving payments of PAYE income and also quarterly.

116. *Paragraphs (6) to (8)* deal with quarterly income tax payments that the employee must make to the Inland Revenue, or can recover in certain cases.

117. *Paragraphs (9) and (10)* concern employees with a "K" code. They put a limit on the amount to be paid in a quarter; and carry forward to future quarters any amounts that have not been paid because of the operation of this limit.

118. *Paragraphs (11) and (12)* supplement the material in earlier paragraphs.

***Background***

119. These regulations have their origins in regulation 2 of SI 1944/1015, which inserted a new regulation 47A in the first PAYE regulations, SI 1944/251. That read as follows:

47A(1) In any case falling within paragraph (1) of Regulation 47, the Inspector, instead of making an assessment under paragraph (2) of that Regulation, may issue a tax deduction card to the employee, specifying the name of the employee, the capacity in which he receives the emoluments and the code appropriate to his case, and where he does so the following provisions of this regulation shall apply.

(2) Whenever the employee receives any emoluments during the year for which the tax deduction card was issued, he shall record on the tax deduction card the gross amount of the emoluments, the date on

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

which he received them, the cumulative emoluments in relation to that date, and the corresponding cumulative tax.

(3) Within fourteen days after the end of every quarter, the employee shall pay to the collector the amount of the cumulative tax corresponding to the cumulative emoluments at the last date during the quarter in question on which he received emoluments (or, in the case of the last quarter of the year, to the cumulative emoluments for the year), reduced by any amounts of tax paid to the collector in respect of the previous quarters of the same year.

(4) If within fourteen days after the end of any quarter the employee has paid no amount of tax to the collector for that quarter, and the collector is unaware of the amount, if any, which the employee is liable so to pay, or if an amount has been paid but the collector is not satisfied that it is the full amount which the employee is liable to pay to him for that quarter, the collector may either—

(a) give notice to the employee requiring him to render within the time limited in the notice, a return in the prescribed form containing particulars all emoluments received by him during the period specified in the notice and such particulars affecting the calculation of the tax payable for the quarter in question as may be specified in the notice; and in such a case the provisions of regulation 28 regarding the ascertainment and certification by the collector of tax payable by an employer, and the provisions of regulation 29 regarding the recovery of any such tax, shall apply with the necessary modifications for the purposes of ascertaining, certifying and recovering the tax payable by the employee as if it were tax which the employee was liable to deduct from paid by him; or

(b) report the facts to the inspector, in which case the inspector shall direct the employee to return the tax deduction card to him and shall make an assessment on the employee under the provisions of regulation 47; and for the purposes of paragraph (6) of that regulation the due dates of the several instalments of the tax payable under the assessment shall be determined as if the notice of assessment had been served twenty-one days before the beginning of the year of assessment:

Provided that no proceedings for the recovery of any instalment shall be commenced within less than twenty-one days after the service of the notice of assessment.

(5) If the employee ceases to receive emoluments he shall forthwith render a return to the collector on the tax deduction card, showing the last date on which he received any emoluments, his cumulative emoluments at that date, and the corresponding cumulative tax.

(6) Not later than fourteen days after the end of the year the employee shall (unless he has previously sent the tax deduction card to the collector with the particulars required by paragraph (5) of this regulation ) render a return to the collector on the tax deduction card, showing his cumulative emoluments at the end of the year and the corresponding cumulative tax; and the provisions of paragraph (4) of regulation 30 regarding the certification and recovery of tax remaining unpaid by an employer for any year shall apply in the case of any tax remaining unpaid by an employer for any year shall apply in the case of any tax remaining unpaid by the employee.

(7) In this regulation, the expression “cumulative emoluments” means in relation to any date, the sum of all emoluments received by the employee from the beginning of the year up to and including that date, irrespective of the person or persons from whom the emoluments were received; and the expression “quarter” means any period of three months beginning 6<sup>th</sup> April, 6<sup>th</sup> July, 6<sup>th</sup> October or 6<sup>th</sup> January.

(8) If the employee receives emoluments in more than one capacity, no account shall be taken for the purposes of this regulation of the emoluments received by him in any capacity other than the capacity specified on the tax deduction card.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

120. That regulation was altered in minor respects up to and including the 1973 consolidation when it became regulation 51 of SI 1973/334.

121. There were further minor changes to regulation 51 of SI 1973/334 until the arrival of K codes. K codes dealt with, for instance, cases where an employee had taxable benefits that were greater than the personal and other allowances to which the employee was entitled. In such cases, K codes increased payments of PAYE income for tax deduction purposes (normally a code reduces payments of PAYE income for tax deduction purposes). With the arrival of K codes, regulation 13 of SI 1992/3180 replaced regulation 51(2) of SI 1973/334 with:

(2) Whenever the employee receives any emoluments during the year for which the deductions working sheet was issued, he shall record on the deductions working sheet—

- (a) the amount of the emoluments;
- (b) the date on which he received the emoluments;
- (c) the cumulative emoluments in relation to that date;
- (d) the cumulative free emoluments or, as the case may be, the cumulative additional pay in relation to that date according to his code;
- (e) the corresponding cumulative tax;
- (f) the amount of tax, if any, deducted or repaid on making the payment of emoluments; and
- (g) where his code reflects additional pay—
  - (i) the tax due at the date on which he received the emoluments,
  - (ii) the overriding limit in relation to the payment;
  - (iii) the amount of tax not deducted as a consequence of the overriding limit.

122. Regulation 13 of SI 1992/3180 also replaced the words “cumulative tax” wherever they appeared in regulation 51(3), (5) and (6) of SI 1973/334 with the words “total net tax deducted”.

123. Following further minor changes regulation 51 of SI 1973/334 was consolidated in a reorganised form as regulation 104 of SI 1993/744.

124. Regulation 17 of SI 1996/1312 made further minor changes to regulation 104 related to self-assessment; because self-assessment was ending schedular assessing from tax year 1996/97 onwards.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

***The provision on which regulation 104(2) of SI 1993/744 is based went wrong following changes (“1992 changes”) made by regulation 13 of SI 1992/3180***

125. Before the 1992 changes, regulation 51(2) of SI 1973/334 essentially required the employee to keep track of what the cumulative tax would be on payments of PAYE income that the employee had received. Regulation 51(3) then required the employee to make quarterly payments to the Inland Revenue of the amount by which the cumulative tax had increased over the quarter.

126. The employee thus paid to the Inland Revenue the same amount of tax as the employer might otherwise have been liable to deduct from the payments of PAYE income.

127. But the mechanics were different in the two cases:

- an employer would normally perform calculations *on the occasion of each payment of PAYE income* and then *deduct (or repay) tax* from (or to) the employee on that occasion. The employer would then account to the Inland Revenue for such deductions or repayments after the end of each income tax period.
- the employee would essentially do calculations *on the occasion of each receipt of PAYE income* (in practice, possibly just one calculation for each quarter). But there was *no deduction (or repayment) tax* by the employee to him or her self on the occasion of each such receipt. The employee would instead account to the Inland Revenue on a quarterly basis for the deductions that an employer might have made during that quarter if “normal PAYE” were being operated.

128. As the 1992 changes were described in the explanatory notes to SI 1992/3180 as being made:

... so as to ensure the [Regulation applies] to the new system of K codes ...

it seems clear that a major change to the mechanics of regulation 51 of SI 1973/334 was not intended.

129. However those 1992 changes introduced references to:

- tax deducted or repaid, or to tax not deducted, on the payment of emoluments; and
- total net tax deducted.

130. The introduction of these references does not fit the underlying mechanics to be operated by an employee and are therefore difficult, perhaps impossible, to make sense of.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

***Approach to 1992 changes taken by these regulations***

131. We have rewritten regulation 104 of SI 1993/744 on the basis of what the 1992 changes intended to achieve. That means removing the notion of the employee deducting or repaying income tax from/to him or her self on the receipt of each payment of PAYE income (see the second bullet of paragraph 127). And we have split this material over four separate regulations to make it more accessible.

132. Regulation 104 is, in this respect, essentially a continuation of the rules that applied before the 1992 changes and almost certainly the way in which regulation 104 of SI 1993/744 is operated in practice.

**Q5. Regulation 104** We welcome comments on the proposed rewrite change to exclude from this regulation notions, in regulation 104 of SI 1993/744, of tax being deducted or repaid on each payment of PAYE income where it is the employee who has to account separately for such tax.

***Employee does not have to operate PAYE on a quarterly basis***

133. Paragraph 1241 of the Inland Revenue's Employment Procedures Manual makes it clear that an employee will not be compelled to operate PAYE on a quarterly basis. The employee would in such a case be dealt with under self assessment.

134. Regulation 104(2) reflects this practice.

**Q6. Regulation 104(2)** We welcome comments on the proposed rewrite change for this regulation to reflect the practice of not compelling an employee to operate PAYE on a quarterly basis.

***Catering for the possibility that the employee may be entitled to a repayment***

135. Regulation 104(3) of SI 1993/744 assumes that there will always be a payment due to the Inland Revenue at the end of each quarter. That assumption goes back to the origins of that regulation – see paragraph 119. The assumption is probably well founded in most practical cases. But there could be cases where the assumption falls down. Perhaps the employee receives little or no PAYE income in a quarter, has extra reliefs coded in or some combination of little income and increased reliefs.

136. Regulation 104(8) therefore admits the possibility that an employee may be entitled to a repayment of tax at the end of a quarter.

**Q7. Regulation 104(8)** We welcome comments on the proposed rewrite change in this regulation to provide that an employee may be entitled to a repayment of income tax after the end of an income tax quarter.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

**Omission of regulation 104(7) of SI 1993/744.**

137. The Inland Revenue does not need regulation 104(7) in order to give a notice to an employee under section 8 of TMA. We therefore propose to omit regulation 104(7) of SI 1993/744.

**Regulation 104A: Direct Collection: failure to pay**

138. This regulation allows the Inland Revenue to require a return from the employee where they are not satisfied that the quarterly payment, if any, from the employee is correct. And it provides for the Inland Revenue to use regulations [47] and [54], the reference is to the working draft regulations published in July, suitably modified, to recover the tax that is unpaid. It is based on regulation 104(5) and (6) of SI 1993/744.

139. *Paragraph (1)* sets out the conditions for the regulation to apply.

140. *Paragraph (2)* allows the Inland Revenue to give a notice requiring a return of certain information.

141. *Paragraph (3)* gives the Inland Revenue the ability to recover from the employee any tax shown in the return but which is unpaid. This paragraph refers to working draft regulations, as at 16 July 2002, in Annex B of paper SC/CC(02)11.

**Regulation 104B: Direct Collection: return on ceasing to receive [PAYE income]**

142. This regulation requires a return where, before the end of the tax year, the employee ceases to receive PAYE income to which the direct collection procedure applies. It is based on regulation 104(9) and (10) of SI 1993/744.

143. *Paragraph (1)* sets out the conditions for the regulation to apply and a return to be made.

144. *Paragraph (2)* sets out the information that must be provided.

**Regulation 104C: Direct Collection: end of year return**

145. This regulation requires a year-end return from the employee in cases where regulation 104B has not required an “in-year” return. There is an exception if the employee delivers a self-assessment tax return shortly after the year end. And there are provisions for recovery of tax where some of the tax shown on the year-end return has not been paid. It is based on regulation 104(11) to (13) and (16) of SI 1993/744.

146. *Paragraph (1)* sets out the conditions for the regulation to apply and a return to be made.

147. *Paragraph (2)* sets out the information that must be provided.

148. *Paragraph (3)* provides an exception to the application of this regulation.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

149. *Paragraph (4)* gives the Inland Revenue the ability to recover from the employee any tax shown in the return but which is unpaid. This paragraph refers to working draft regulations, as at 16 July 2002, in Annex B of paper SC/CC(02)11.

150. *Paragraph (5)* applies section 98A of TMA (special penalties in the case of certain returns) to the return required by this regulation.

*These notes refer to Part 8 of the draft PAYE regulations as at 20 December 2002.*

## **SUMMARY OF QUESTIONS**

- Q1. Regulation 101A(4) We welcome comments on the proposed (consequential) rewrite change to add, for self assessment purposes, amounts of tax overpaid in the earlier year (to the extent reflected in a coding adjustment for the later year) to the tax actually deducted under PAYE in that later year..... 11
- Q2. Regulation 101A We welcome comments on the proposed rewrite change to include in this regulation an explicit calculation of the “cap” on notional credit. We also welcome comments on the proposed explicit cap in paragraph (5) of this regulation. .... 12
- Q3. Regulation 101B(2) to (5) We welcome comments on the proposed rewrite change for the regulations to reflect practice on coding adjustments to collect underpayments. .... 14
- Q4. Regulation 101B(6) We welcome comments on the proposed rewrite change to permit, subject to a taxpayer’s right to object, overpayments of tax for a year to be refunded by making coding adjustments in a later year..... 14
- Q5. Regulation 104 We welcome comments on the proposed rewrite change to exclude from this regulation notions, in regulation 104 of SI 1993/744, of tax being deducted or repaid on each payment of PAYE income where it is the employee who has to account separately for such tax..... 23
- Q6. Regulation 104(2) We welcome comments on the proposed rewrite change for this regulation to reflect the practice of not compelling an employee to operate PAYE on a quarterly basis. .... 23
- Q7. Regulation 104(8) We welcome comments on the proposed rewrite change in this regulation to provide that an employee may be entitled to a repayment of income tax after the end of an income tax quarter..... 23