These notes refer to the Income Tax (Earnings and Pensions) Act 2003 (c.1) which received Royal Assent on 6th March 2003

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

The Income Tax (Offices and Employments) Act 1944 (7&8 Geo. 6. (1943-44) c.12)

Extension of principal Act (subject to exceptions) to all emoluments taxable under Schedule E

"**1**(1) Subject to the provisions of this Act, the Income Tax (Employments) Act, 1943 (hereafter in this Act referred to as "the principal Act") shall extend to all emoluments assessable to income tax under Schedule E, other than pay, pension or other emoluments payable in respect of any service in or with the armed forces of the Crown, and accordingly that Act shall have effect as if for subsections (2) to (4) of section one thereof there were substituted the following subsection –

"(2) The said emoluments (hereafter in this Act referred to as "emoluments to which this Act applies") are all emoluments assessable to income tax under Schedule E, other than pay, pension or other emoluments payable in respect of any service in or with the armed forces of the Crown".

2729. Both the 1943 and 1944 Acts were short and contained mainly transitional provisions. The details of PAYE were then, as now, left for regulations made under section 2 of the 1943 Act.

The scope of PAYE

2730. The scope of PAYE was extended by subsequent Acts to all income assessable under Schedule E; and the scope of Schedule E was itself also extended. Highlights were:

- section 27 of FA 1946 and section 24 of FA 1949 taxed as emoluments chargeable under Schedule E various National Insurance benefits;
- section 30(3) of FA 1946 extended PAYE to the armed forces for 1947-8 and subsequent years;
- section 38 of FA 1948 treated certain payments of expenses and benefits in kind as emoluments assessable under Schedule E and so brought them within the scope of PAYE;
- section 10 of FA 1956 moved foreign employments from Case V of Schedule D to Schedule E;
- sections 37 and 38 of and Schedule 4 to FA 1960 charged under Schedule E (and so brought within PAYE) some termination payments – the pre-cursor of section 148 of ICTA;

- Schedule 4 to the Income Tax Management Act 1964 amended sections 157 and 158 of ITA 1952 (as the PAYE provisions had become on consolidation) to include in the meaning of emoluments all income assessable to tax under Schedule E. This brought non-approved retirement benefits within PAYE and removed doubts about the treatment of certain pensions;
- section 25 of FA 1966 charged under Schedule E any gain on the exercise of a share option obtained as an employee when the option is exercised (see now section 135 of ICTA);
- further charges were introduced in sections 79 to 89 of FA 1972 on shares acquired as a result of rights employees get by reason of their employment (some of which were then removed or replaced by sections 77–80 of FA 1988);
- section 38 of F(No. 2)A 1975 brought agency workers within Schedule E in 1975 – mainly so as to apply PAYE to their pay;
- section 30 of FA 1981 (see now section 149 of ICTA) made taxable under Schedule E any sick pay paid by reason of the employment as a result of arrangements entered into by the employer if it would not already be taxable;
- other reliefs and exemptions from time to time to encourage share ownership and/ or employee participation also give rise to charges and may require the trustees of the scheme to operate PAYE: see for example Schedule 8 to FA 2000;
- section 27 of FA 1981 made unemployment benefit taxable as Schedule E income;
- section 29 of and Schedule 3 to FA 1987 (see now section 151 of ICTA) taxed some payments of income support as Schedule E income;
- section 139(1) and (3) of FA 1994 made incapacity benefit taxable under Schedule E (with important exceptions); and
- the Jobseekers Act 1995 inserted section 151A of ICTA which made jobseeker's allowance (broadly the successor to unemployment benefit) Schedule E income.

2731. The point of this selective list is two-fold:

- PAYE extends to much more than "ordinary" wages and salaries; but
- PAYE copes with all this (and more) because something either is or is not income assessable under Schedule E; and either is or is not a payment of such income.

What is and is not a payment for PAYE

2732. The distinction between what is and is not a *payment* of Schedule E income matters because:

- a person making a payment of Schedule E income must, subject to the PAYE regulations, deduct tax in accordance with the regulations;
- a person providing income without making a payment does not have to deduct tax (but may still have to comply with requirements in the regulations to report it – for example the report of benefits in kind and expenses on form P11D).

2733. The boundary between what is and is not a payment was used to avoid PAYE (often as part of attempts also to avoid National Insurance Contributions). This led to legislation to treat income as paid – mainly in:

- section 127 of FA 1994 which inserted section 203F to 203L of ICTA. These, broadly speaking, treated as payments any income provided in the form of tradeable assets; and

- section 65 of FA 1998 which amended and extended the 1994 legislation to cover a wider range of things which could readily be converted into money.

Machinery of PAYE

2734. There have also been a few changes to the machinery of PAYE – but remarkably few given the nearly 60 years since the 1943 Act:

- section 30 of FA 1948 (see now section 205 of ICTA) removed the need for assessments in some cases;
- section 28 of FA 1961 (see now section 206 of ICTA) dealt with an unintended effect of the legislation in 1948. See the commentary on section 709;
- section 92 of F(No.2)A 1987 provided powers to charge interest on amounts outstanding from employers after the end of the tax year. Section 128 of FA 1988 extended this to provide for interest to be paid by the Inland Revenue to employers who have overpaid. See section 684;
- section 45 of FA 1989 inserted section 203A of ICTA which defines when a payment is made for PAYE purposes (in step with the changes made in 1989 to tax earnings on the basis of when they are received). See the commentary on section 686;
- FA 1995 made minor amendments to the legislation for the introduction of self assessment for income tax – see for example *Note 62* in Annex 2; and
- section 110 of FA 1996 made provision for "PAYE settlement agreements" (PSAs) in place of long-standing informal arrangements for employers to meet employees' tax: see paragraph 2849.

Chapter 1: Introduction

Overview

2735. *Section 682* introduces the Part.

2736. *Section 683* defines PAYE income.

Section 682: Scope of this Part

2737. This section is purely introductory. It gives readers an indication of what they will find in the Part.

Section 683: PAYE Income

2738. This section defines "PAYE income". It is new.

2739. The term "PAYE income" takes the place of "income assessable under Schedule E" which is used in section 203 of ICTA. The meaning of "PAYE income" might be thought to be different from "income assessable under Schedule E". But on close examination it has the same meaning. See *Note 55* in Annex 2.

2740. *Subsection (1)* defines PAYE income as the sum of the three amounts defined in this section.

2741. *Subsection (2)* defines PAYE employment income using the terms introduced in Chapter 3 of Part 2 (see the commentary on page 12).

2742. *Subsections (3)* and *(4)* define PAYE pension income for the year. This is taxable pension income (as defined in Part 9) which:

- is taxable pension income for the year; and
- would be charged under Schedule E in ICTA.

2743. *Subsection (5)* similarly defines PAYE social security income as the total of any social security income (as defined in Part 10) which:

- is taxable social security income for the year and
- would be charged under Schedule E in ICTA.

2744. Finally, the label "PAYE income" may not be ideal in all respects. This is because:

- it is accurately labelling all the income which is subject to PAYE in the sense that PAYE must try to collect the tax on it; but
- not all PAYE income will be subject to PAYE in the sense of deductions: only *payments* of PAYE income will be subject to those.

2745. But this is no different from the present position with income assessable under Schedule E. In the course of consultation users welcomed the label "PAYE income" as plain language; and felt the subsequent sections (and the PAYE regulations) would make clear the distinction between PAYE income and payments of PAYE income.

Chapter 2: PAYE: general

Overview

2746. *Section 684* requires the Board to make regulations to collect income tax on PAYE income. These regulations include in particular requirements for those making payments of PAYE income to deduct tax by reference to tax tables.

2747. *Section 685* requires the tax tables to try to collect the right amount of tax on the PAYE income by the end of each tax year and to try to do so evenly.

2748. *Section 686* defines when a payment of PAYE income is made for PAYE purposes (in the same way as section 18 defines when earnings are received for the purposes of Part 2).

Section 684: PAYE regulations

2749. This section provides powers for the Board of Inland Revenue to make PAYE regulations. It derives mainly from part of section 203 of ICTA.

2750. Item 5 derives from section 203(10). It allows PAYE regulations to provide for the way in which any matters dealt with in the regulations are to be proved – for example in proceedings to recover tax. Section 203(10) also includes provision for proving the contents or transmission of anything that, by virtue of the regulations, takes an electronic form or is transmitted to any person by electronic means. This Part of the provision was enacted to deal with electronic filing, a predecessor of filing by internet. It is due to be repealed by section 139 of and Part VII of Schedule 20 to FA 1999 from a date laid down by Order, and is therefore omitted. Paragraph 89 of Schedule 7 to this Act preserves the omitted words in the meantime.

2751. Items 10 and 11 derive from sections 203L(4) and 206A(6) of ICTA but are applied more widely in this Act. See *Change 147* in Annex 1.

2752. *Subsection (8)* defines the term "PAYE regulations" for the purposes of this Act and of other legislation. This allows other legislation to refer more briefly and naturally to "PAYE regulations" rather than to "regulations made under section 684 of the Income Tax (Earnings and Pensions) Act 2003".

2753. This section omits as unnecessary the provision in section 203(1) that deductions are to be made from payments "notwithstanding that when payment is made no assessment has been made in respect of the income". See *Note 57* in Annex 2.

2754. Section 203(3A) is also omitted from this section as unnecessary. Section 203(3A) is a transitional rule from the introduction of independent taxation in FA 1988. It cannot affect any tax year to which this Act applies.

Section 685: Tax tables

2755. This section requires the Board to produce tax tables for PAYE which aim to collect the right tax for the tax year. It derives from section 203(6), (7) and (8) of ICTA.

2756. *Subsection (1)* requires the Board to produce tax tables which, where possible, result in:

- tax on PAYE income for a year being deducted from PAYE income paid during that year; and
- even deductions of tax through the year so, for example, a twelfth of the total tax estimated to be due for the year is collected after one month, a sixth of the (possibly revised) total tax is collected after two months, and so on.

2757. The main practical effect of *subsection (2)* is to collect underpayments through PAYE rather than by the taxpayer making a lump sum payment.

2758. *Subsection (3)* provides that, in trying to collect tax evenly, it can be assumed that the rate of past payments in the tax year is a guide to the rate of future payments.

Section 686: Meaning of "payment"

2759. This section deals with the meaning of "payment" in this Part. It derives from section 203A and part of section 202B of ICTA.

2760. Section 203A was introduced in 1989 as part of the package of changes dealing with the switch to a receipts basis of assessment. Prior to 1989 income under Cases I and II of Schedule E was assessed on an arising basis, whereas PAYE deductions were made when the emoluments were paid. The 1989 reforms made the emoluments assessable at the same time that they were paid for PAYE purposes. They provided :

- a definition of receipt in section 202B of ICTA to determine the time that emoluments were assessable, and
- a definition of payment in section 203A of ICTA.

2761. These definitions are essentially the same. This section therefore matches section 18, which derives from section 202B.

2762. In consultation leading up to this Act some users said that the heading of the section was inappropriate because it deals only with the timing of a payment. The section reproduces the heading from section 203A. It is on close examination appropriate. Section 203A and this section are not only giving the time of a payment. They also make some things which would not be payments into payments for PAYE purposes. A simple example is where an employee is entitled to collect a bonus of £1,000 on Monday. That is a payment for PAYE purposes on Monday even if the employee does not get around to collecting the money until later.

2763. *Subsection (1)* provides that for the purposes of the PAYE regulations, any payment of (or on account of) PAYE income is a payment for PAYE purposes at the earliest time given by any of the dates derived from the rules given.

2764. Rule 3 derives from section 203A(2), and Rule 3(a) from section 203A(4).

2765. *Subsection (2)* provides that a person is treated as a director for the purposes of rule 3 in subsection (1) if he or she is a director at any time during the tax year.

2766. *Subsections (3)* and *(4)* derive from section 203A(5), and from section 202B(5) and (6). In section 203A(5) reference is made to the definition of director in section 202B(5) and (6). It is more helpful to readers to repeat the definition here.

Chapter 3 PAYE: special types of payer or payee

Overview

2767. This Chapter deals with PAYE obligations where there are special types of payer or payee. The majority of these provisions were introduced to counter avoidance of PAYE – see paragraph 2733.

2768. *Section 687* treats certain payments of PAYE income actually made by an intermediary of an employer as made by the employer.

2769. *Section 688* treats agency workers who are treated as having earnings by section 44 as employees of the agency for the purposes of most of the provisions for special types of payer, payee and types of income in this Chapter and Chapter 4. It also treats the client rather than the agency as the employer for the purposes of those provisions in relation to some payments.

2770. *Section 689* deals with employees who work in the United Kingdom but whose employer is not subject to PAYE regulations, typically where the employer has no UK presence. It treats the person for whom an employee works in the United Kingdom as if that person had made certain payments which are actually made by the employer or an intermediary of the employer.

2771. *Section 690* applies only to employees who are not resident (or not ordinarily resident) in the United Kingdom and who work partly in the United Kingdom and partly not. It treats payments of income of the employee as payments of PAYE income. It also provides for the Inland Revenue to direct that only a proportion of such payments be treated as PAYE income.

2772. *Section 691* deals with workers provided by contractors. It provides for the Board to direct that PAYE must be operated by the person employees actually work for rather than their employer if that person pays for their work and the employer is not likely to operate PAYE properly.

2773. *Section 692* provides for regulations to require PAYE to be operated on tips which are collected and shared among a group of employees by the person who runs that arrangement. It also provides for the employer to operate PAYE in some circumstances if the person who shares out the tips fails to do so properly.

Section 687: Payments by intermediary

2774. This section deals with payments made by intermediaries. It derives from section 203B of ICTA.

2775. Section 203B was introduced as part of a package of PAYE provisions in FA 1994. It prevents avoidance of PAYE by using an intermediary not subject to PAYE regulations to make payments. An example is an intermediary outside the UK tax net.

2776. *Subsection (1)* states the basic proposition that a payment of income by an intermediary is treated as a payment by the employer. This section (like others in this and later Chapters) refers explicitly to “employer” and “employee”. These terms take their meanings from section 712. The commentary on them uses the words in the same sense.

2777. *Subsection (2)* disapplies subsection (1) if the intermediary complies with the PAYE regulations. The wording in this Act makes it clearer that the intermediary must *both*

deduct *and* account for tax in accordance with the PAYE regulations. See *Note 58* in Annex 2.

2778. Similar clarifications have been made in sections 689(1)(d) and 691(1)(c).

2779. Section 203B(5) applies section 839 of ICTA to give the meaning of connected persons. Section 718 does that for this Act as a whole so no provision to that effect is needed in subsection (4).

Section 688: Agency workers

2780. This section ensures that agency workers are, broadly speaking, treated in the same way as other workers for the purposes of this Part. It derives from section 203L(1A), (1B) and (1C) of ICTA.

2781. Subsection (1) provides that where section 44 (agency workers) applies then this Chapter (except section 691), Chapter 4 and section 710 apply as if the agency employed the worker.

2782. *Subsection (2)* treats the client rather than the agency as the employer if a payment is made by an intermediary of the client.

Section 689: Employee of non-UK employer

2783. This section concerns employees working in the United Kingdom for someone who is not their employer. It derives from section 203C of ICTA.

2784. The section provides for tax to be accounted for under PAYE by the person for whom the employee is working if the employer does not do so. An example is an employee of an overseas company who comes to the United Kingdom to work for a subsidiary but not as an employee of the subsidiary. The employer remains overseas and cannot be required to operate PAYE. It may also be impracticable for it to do so.

2785. *Subsection (1)(d)* follows the approach taken in section 687. See *Note 58* in Annex 2.

2786. *Subsection (4)* deals with the possibility that income is provided to the employee in the form of a voucher, credit card, readily convertible asset or other way which gives rise to a "notional payment". It treats any such notional payments in the same way as actual payments for the purposes of this section. But (as with notional payments generally) there is no requirement to "gross up" the notional payment for PAYE purposes.

Section 690: Employee non-resident etc.

2787. This section makes special provisions for PAYE for employees who are *both* non-resident (or not ordinarily resident) *and* working partly in the United Kingdom and partly not. It derives from section 203D of ICTA.

2788. An employee in these circumstances may be chargeable to income tax on only some of the employment income. Payments which were partly of PAYE income and partly not would not be subject to deductions. This section provides that payments (or a proportion of payments) are subject to PAYE.

2789. *Subsection (2)* provides for a direction to be made, on application by the "appropriate person" (see subsection (3)) to the Inland Revenue. The direction states what proportion of income from that employment is to be subject to PAYE deductions. It contains two minor changes:

- directions under this section affect only PAYE income paid by or on behalf of the employer. This change is then followed through in subsections (3)(b), (7) and (8). See *Change 148* in Annex 1.

- it allows a direction to be made where the income which is not assessable *is* ascertainable. See *Change 149* in Annex 1.

2790. *Subsection (7)* ensures that when a payment to which a direction under subsection (2) applies is made to the employee, PAYE deductions are made from the proportion of the payment specified in the direction. This is achieved by deeming the proportion to be PAYE income.

2791. *Subsection (8)* sets out the position if no direction is made. Then all the payment is subject to PAYE.

2792. *Subsection (9)* makes sure that this section does not affect the employee's tax liability.

2793. *Subsection (10)* is new. It deals with how this section is modified if both it and section 689 apply to the same employment. This could happen if the employer (or an intermediary of the employer) is outside the UK tax net. Section 689 might then lead a person in the United Kingdom for whom the employee is working to have to operate PAYE. See *Change 149* in Annex 1.

Section 691: Mobile UK workforce

2794. This section provides that where, in the case of a contractor providing their employees to a person, it is unlikely that PAYE will be deducted or accounted for, the Board of Inland Revenue may direct that that person must deduct and account for tax. It derives from section 203E of ICTA.

2795. *Subsection (1)* sets out the conditions for the section to apply and labels as the "relevant person" the person for whom the employees work. Subsection (1)(c) follows the approach taken in section 687. See *Note 58* in Annex 2.

2796. *Subsection (2)* sets out what the Board may do by way of a direction. This is broadly to require the relevant person to deduct tax when making payments for the work. This need not be a payment to the employees. It may be a payment to the contractor.

2797. *Subsection (3)* sets out what the direction must do and how it may at any time be withdrawn.

2798. *Subsection (4)* requires the Board to try to give the contractor a copy of any direction.

2799. *Subsection (5)* deals with the effect of a direction under subsection (2). When there are employees of the contractor working for the relevant person then the relevant person is to make deductions in accordance with PAYE regulations from any payment made for the work done (whether a payment to the contractor or another person). This is to be done by treating the amount of the payment attributable to each employee's work as if it were a payment of PAYE income to that employee.

Section 692: Organised arrangements for sharing tips

2800. This section allows the PAYE regulations to make provision for PAYE to be operated on tips which are collected and shared among a group of employees by whoever runs that arrangement; and also to require the employer to operate PAYE in some circumstances if that person fails to operate PAYE properly. It derives from regulation 5 of the Income Tax (Employments) Regulations 1993 (S.I. 1993 No 744).

2801. This section is included in to give readers a more complete set of provisions which deal with who is the "employer" for PAYE purposes.

2802. Regulation 5 originated in SI 1965 No 516. It was introduced then to make clear that a person (other than the employer) who distributes to employees money from an organised arrangement for sharing tips had the same responsibilities as an employer,

unless the Board directed otherwise. This legislation was amended by SI 1994 No 775 to make clear what happens if such a person does not operate PAYE properly.

2803. The regulations refer to the person who shares the tips as the "tronc-master". This term is still used in practice in some such schemes. It is not used in this Act as users commented in the course of consultation that it was archaic and/or obscure. The term will be omitted from the regulations when they are rewritten.

2804. These provisions are in the current PAYE regulations and have been for many years but their inclusion in this Act is a minor change in the law. See *Change 150* in Annex 1.

Chapter 4: PAYE: special types of income

Overview

2805. This Chapter treats as payments of PAYE income the provision of PAYE income in the form of cash vouchers and readily convertible assets, and certain non-cash vouchers and credit tokens which are or are for readily convertible assets. It also treats as payments certain share-related employment income.

2806. *Section 693* deals with the receipt of cash vouchers (for example traveller's cheques) by employees. It provides when the payment is made for PAYE purposes. It also provides exceptions to that rule and for the PAYE regulations to make further exceptions.

2807. *Sections 694* to *702* deal with income provided in the form of readily convertible assets, or vouchers or credit tokens for such assets; enhancements to the value of readily convertible assets already held by employees; gains from options on shares which are readily convertible assets, or conditional interests in shares which are readily convertible assets being sold or ceasing to be conditional. These are all circumstances in which there is employment income which is taxable but which would not be a payment for PAYE purposes. The sections treat a payment of PAYE income as made and where necessary provide also how the amount of the payment should be calculated.

Section 693: Cash vouchers

2808. This section provides for PAYE to be operated on the provision of cash vouchers. It derives from section 203I of ICTA and from regulations.

2809. *Subsection (1)* provides that where a cash voucher is chargeable to tax under Chapter 4 of Part 3 of this Act then the provision of the cash voucher is treated as a payment of PAYE income. The amount of the payment is the amount treated as earnings by section 81(1). The subsection also picks up the rule in section 143(1)(a) of ICTA that determines the time of payment. The cash voucher is treated as a payment of PAYE income at the time it is received by the employee.

2810. *Subsections (2)* and *(3)* together keep out of PAYE such things as traveller's cheques used by employees while travelling in the performance of their duties. They deal respectively with vouchers used direct to meet expenses and vouchers used to get cash to meet expenses.

2811. There is also no requirement to operate PAYE on cash vouchers which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to the voucher.

2812. "Cash voucher" is defined in section 721.

Section 694: Non-cash vouchers

2813. This section provides for PAYE to be operated on certain non-cash vouchers. It derives from section 203G of ICTA and from regulations.

2814. *Subsection (1)* provides that, if the conditions of this section are met, then the provision of a non-cash voucher will constitute a payment of PAYE income of an amount equal to the amount treated as earnings under section 87(1).

2815. *Subsection (2)* states when the section applies to a non-cash voucher. This is when either of the conditions in subsections (3) and (4) are met and the voucher is not excluded by PAYE regulations.

2816. But there is no requirement to operate PAYE on non-cash vouchers which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to the voucher.

2817. *Subsection (3)* provides for a non-cash voucher to fall within this section, and therefore within PAYE, if it is exchangeable for a readily convertible asset.

2818. *Subsection (4)* provides that a non-cash voucher falls within this section if it would itself be regarded as a readily convertible asset for the purposes of section 696 but for the fact that section 696 does not apply to non-cash vouchers (because they are dealt with by this section).

2819. *Subsections (5)* and *(6)* derive from regulation 6(1) to (3) and 2(1) of the Income Tax (Employments) (Notional Payments) Regulations 1994 (SI 1994 No 1212). They determine when a payment is made and what "cheque voucher" and "cost of provision" mean.

2820. *Subsection (7)* is the same rule about appropriation of vouchers as in section 82(3).

2821. "Readily convertible asset" is defined in section 702. "Non-cash voucher" is defined in section 721.

Section 695: Credit-tokens

2822. This section provides for PAYE to be operated on certain credit-tokens used by an employee. It derives from section 203H of ICTA and regulations.

2823. *Subsection (2)* derives from paragraph 4 of SI 1994 No 1212. It excludes from the scope of the section credit-tokens used to obtain money to meet expenses which would only be PAYE income because of section 70.

2824. As with vouchers, there is also no requirement to operate PAYE on credit-tokens which are subject to a dispensation (see section 96) as Chapter 4 of Part 3 then does not apply to give rise to an amount treated as earnings under section 94.

2825. "Readily convertible asset" is defined in section 702. "Credit-token" is defined in section 721(1).

Section 696: Readily convertible assets

2826. This section requires provision of PAYE income to an employee in the form of a readily convertible asset to be treated as payment by the employer, and gives the amount of the notional payment. It derives from section 203F of ICTA.

2827. "Readily convertible asset" is defined in section 702.

Section 697: Enhancing the value of an asset

2828. This section treats as the provision of PAYE income in the form of a readily convertible asset anything which enhances the value of an asset which an employee already has if the asset (as enhanced) is a readily convertible asset. It derives from section 203FA of ICTA and regulations.

2829. *Subsection (1)* sets out the circumstances in which this section applies.

2830. *Subsection (2)* then provides for section 696 to apply as if the income were provided in the form of a readily convertible asset. Then (subject to the details of section 696) it will be a "notional payment" on which PAYE must be operated.

2831. *Subsection (4)* derives from paragraph 3B of the Income Tax (Employments) (Notional Payments) Regulations 1994, SI 1994 No 1212. It excludes from this section things which are excluded from readily convertible assets: see section 701(2)(c).

Section 698: PAYE: shares ceasing to be only conditional or being disposed of

2832. This section deals with employment income under section 427 (Charge on interest in shares ceasing to be only conditional or on disposal) – see paragraph 1853. It derives from parts of section 203FB of ICTA.

2833. Section 203FB of ICTA provides, in summary, that PAYE applies to share-related events where the shares are readily convertible assets. It deals with several such events. These are divided here between this section and sections 699 and 700 to make them easier to relate back to the way Chapters 2, 3 and 5 of Part 7 give rise to employment income in such cases. But these are complex events which involve some complex rules.

2834. *Subsections (1)* and *(2)* set out the circumstances in which this section applies.

2835. *Subsection (3)* provides that in those circumstances the event is treated as if a further interest in shares had been provided. PAYE may then apply – although that depends on for example whether or not it is a readily convertible asset.

2836. *Subsection (4)* provides that if section 696 requires PAYE to be operated in these circumstances the amount of the notional payment for PAYE purposes is the amount which is likely to be chargeable under Chapter 2 of Part 7.

2837. *Subsection (5)* applies to this section the meaning given by Chapter 2 of Part 7 to expressions such as "shares" (see section 434).

Section 699: PAYE: conversion of shares

2838. This is the second of the three sections derived from section 203FB of ICTA. It deals with employment income under section 438 on the conversion of convertible shares.

2839. The section takes broadly the same approach as section 698.

Section 700: PAYE: gains from share options

2840. This is the third of the three sections derived from section 203FB of ICTA. It deals with employment income under sections 476 (Charge on exercise, assignment or release of option by employee) and 477 (Charge on employee where option exercised, assigned or released by another person).

2841. The section takes broadly the same approach as sections 698 and 699 but includes minor changes.

2842. *Subsection (3)* deals with the assignment or release of the right to acquire shares. Where this happens the consideration might be a cash payment or an asset. Sections 684 to 691 and 696 could be relevant – depending on whether the consideration is a payment made direct, payment by an intermediary, the provision of an asset or whatever.

2843. Subsection (3)(a) deals with consideration in the form of a payment. It treats as a payment of PAYE income a proportion of the amount chargeable under sections 476 or 477 less any relief likely to be due under section 481. Having regard to the relief which is likely to be due is a minor change to remove an inconsistency in section 203FB. See *Change 151* in Annex 1.

2844. *Subsections (3)* and *(4)* together include a further minor change in the law. This is to ensure the total amount subject to PAYE does not exceed the employment income. See *Change 151* in Annex 1.

2845. *Subsections (6)* and *(7)* give "asset" in this section a meaning which includes cash vouchers and certain non-cash vouchers and credit-tokens. See *Change 152* in Annex 1.

Section 701: Meaning of "asset"

2846. This section defines "asset" for the purposes of Chapter 4. It derives from section 203F(4) and (5) of ICTA and regulations.

Section 702: Meaning of "readily convertible asset"

2847. This section defines "readily convertible asset" in Chapter 4. It derives from parts of sections 203F and 203K of ICTA.

2848. Section 203F(6) defines "money" to include the European currency unit (ECU). That is no longer needed. See *Note 59* in Annex 2.

Chapter 5: PAYE settlement agreements

Overview

2849. This Chapter allows regulations to provide for an employer to agree to pay sums to the Board of Inland Revenue in respect of the income tax on certain earnings of employees. And for the employees to be correspondingly relieved of their liabilities to income tax in respect of those earnings.

2850. *Section 703* is introductory.

2851. *Sections 704* to *706* set parameters within which regulations can be made for PAYE settlement agreements.

2852. *Section 707* provides definitions.