

INCOME TAX (EARNINGS AND PENSIONS) ACT 2003

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Background

2716. PAYE is the biggest part of the income tax system; and for many people their only contact with income tax. There are 1.5 million PAYE schemes operated by employers, pension providers and others. They deal with around 35 million employments, offices, pensions and so on. (In the rest of the commentary on Part 11, as in the PAYE regulations, “employee” is generally used to mean anyone getting income within the scope of PAYE. “Employer” and “employment” should generally be read accordingly.) Most of the £160 billion income tax and national insurance contributions collected by the Inland Revenue comes through PAYE.
2717. The core of PAYE is deduction at source. This means that employers deduct tax when they make payments to employees. The amount they deduct depends on:
- PAYE tables issued by the Inland Revenue for employers and employees generally;
 - a PAYE code issued by the Inland Revenue for each individual employee and employment; and
 - the amount the employer pays and (usually) the cumulative total of previous payments in the tax year.
2718. The PAYE code:
- gives each employee the allowances and reliefs to which they are likely to be entitled for the tax year;
 - subtracts any allowances needed to cover other employment income – eg benefits in kind such as company cars; and
 - can also collect underpayments of tax from earlier years.
2719. As a result the majority of employees never have to make a lump sum payment to the Inland Revenue. Employees remain liable for income tax on the basis of their income for the tax year. But PAYE deductions from their income are in effect “payments on account” of that tax bill. So more often than not employees end the year having paid the right amount of tax or near enough the right amount for the difference to be dealt with by collecting an underpayment through PAYE in a later year (or by repaying employees if it turns out too much has been deducted).
2720. The PAYE tables give employees an equal share of their allowances and reliefs each week or month. Combined with the way PAYE deductions are usually worked out using the total payments to date (the “cumulative basis”) this means that employees:
- pay tax evenly over the year; and

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

- are far more likely to pay the right amount of tax by the end of the year.

2721. These were objectives of PAYE from the outset.