

EXPLANATORY MEMORANDUM TO
THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT) REGULATIONS
2012

2012 No. 822

1. This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

2. **Purpose of the instrument**

2.1 These Regulations make the amendments to the Income Tax (Pay As You Earn) Regulations (S.I. 2003/2682) (the 2003 Regulations) necessary for the introduction of HMRC's Real Time Information programme (RTI) from April 2012 and the closure of the Simplified PAYE Deduction Scheme (SPDS) to new employers from 6th April 2012.

2.2 These Regulations also amend the 2003 Regulations to ensure that where a payment made to an employee in the form of employment related securities by a former employer or another person on behalf of that employer after the employment has ceased and not included in Form P45 will be taxed using the 0T tax code on a non-cumulative basis.

2.3 These Regulations also amend the 2003 Regulations to give HMRC the power to require security or further security for the payment of sums due from an employer under the PAYE system. The amendments set out the circumstances in which security may be required, who it may be required from, the procedural requirements to be satisfied where security is sought and appeal rights. They also specify the period of time that an employer has to give the security sought before the offence of failure to provide security in section 684 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) is committed.

3. **Matters of special interest to the Select Committee on Statutory Instruments**

None.

4. **Legislative Context**

RTI

4.1 The 2003 Regulations govern the operation of the Pay As You Earn (PAYE) system under which income tax is deducted at source from employee's pay. Certain other deductions are also made under the PAYE system.

4.2 Under the 2003 Regulations, employers must report to HMRC after the end of each tax year what payments have been made to their employees and the tax deducted. During the year, employees who change employments are given a Form P45 by their former employer and pass this to their new employer so that the new employer has the necessary information to correctly operate PAYE. If no Form P45 is available, the 2003 Regulations set out an alternative procedure involving Form P46. Forms P45 and P46 are also used by employers to notify HMRC of changes in employment.

4.3 Under RTI, employers will be required to report payments to employees and the deduction of tax to HMRC each time a payment is made. This will be done using a new form of return. Each return will be required to contain certain information about the way that the employee's pay and tax has been calculated and will also be used to report changes in employment.

4.4 These Regulations make the necessary amendments to the 2003 Regulations to give effect to these changes and also contain a number of amendments consequential to the main changes. In particular, they insert into the 2003 Regulations provisions which deal with the phasing in of RTI for different employers between April 2012 and October 2013.

4.5 These Regulations also contain freestanding transitional provisions which will require employers to provide certain information to HMRC at the point they join RTI.

4.6 The collection of National Insurance contributions (NICs) and student loan repayments rely on the PAYE system, as does the income tax construction industry scheme (CIS). Amendments to the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) and the Income Tax (Construction Industry Scheme) Regulations 2005 (S.I. 2005/2045) are being made by HMRC at the same time as these Regulations to reflect the introduction of RTI. The Department for Business, Innovation and Skills is similarly making regulations amending the Education (Student Loans) (Repayment) Regulations 2009 (S.I. 2009/470).

SPDS

4.7 These Regulations also amend the provision that allows certain employers to use the SPDS, closing the scheme to new participants from 6th April 2012. New employers who would have previously satisfied the conditions for using the SPDS will be required to operate standard PAYE. Existing users are not affected by this change and will be able to continue using the SPDS.

Code OT

4.8 Regulation 37 of the 2003 Regulations applies when a former employer or another person acting on the behalf of that employer makes a payment to an employee after the employment has ceased, and which is not included on Form P45. Where that payment is in the form of securities, an

interest in securities or securities option, the employer must currently deduct tax from the payment at the basic rate. All other forms of payments are taxed using code 0T on a non-cumulative basis. As a result of these amendments, tax from all types of payments must now be deducted using code 0T.

4.9 These Regulations remove regulations 37(2A) and 37(2B) of the 2003 Regulations, which provided for the basic rate of tax to apply when deducting tax from payments in the form of securities, interests in securities or securities options. Paragraphs 2A and 2B were inserted into regulation 37 of the 2003 Regulations by the Income Tax (Pay As You Earn) (Amendment No. 2) Regulations 2011 (S.I. 2011/1054) and created an exception, in relation to securities, interests in securities or securities options to the requirement in paragraph 2 of regulation 37 that tax must be deducted from PAYE income paid after the employment has ceased on the non-cumulative basis using the 0T code.

Securities

4.10 Item 4B in section 684(2) of ITEPA allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for and in connection with the giving of security for the payment of PAYE. Item 4B was inserted by section 85 of the Finance Act 2011. This is the first use of the power.

4.11 These Regulations amend the 2003 Regulations to make provision allowing HMRC to require security for the payment of PAYE for the purposes of protecting the revenue. They set out who security may be required from, the procedural requirements to be satisfied by HMRC when it seeks security and the appeal rights of those from whom security is required.

4.12 Section 684(4A) of ITEPA, inserted alongside item 4B, provides that a person from whom security is required commits an offence if they fail for a specified period to give that security. These Regulations set out the time limits for providing security, after which an offence is committed.

4.13 Amendments to the Social Security (Contributions) Regulations 2001 (S.I. 2001/1004) being made by HMRC at the same time as these Regulations make equivalent provision in relation to Class 1 and 1A NICs.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- *What is being done and why*

RTI

7.1 PAYE has been operating in its current form for some 60 years. RTI is being introduced from April 2012 to bring PAYE into the 21st century by making it easier for employers, pension providers and HMRC to administer and over time more accurate for some individuals by improving the processes relating to joiners and leavers.

7.2 Under RTI employers and pension providers will tell HMRC about PAYE payments and deductions they make (tax, NICs, Student Loan repayments, etc) at the time they pay their employees, as opposed to the end of the year as happens now.

7.3 Instead of PAYE being a separate process for employers and pension providers, the RTI process will be integrated within the payroll process. RTI is expected to make the 'leaver' and 'joiner' process smoother which, over time, should mean that those who change jobs frequently will be more likely to pay the right amount of tax at the right time. Payroll software will collect the information and send it to HMRC electronically – with the smallest employers able to download HMRC's free 'Basic PAYE Tools'.

7.4 In addition, RTI will also support the operation of Universal Credit due to commence in October 2013. The DWP will have access to necessary RTI information to identify earnings of Universal Credit claimants thereby ensuring that the correct payment in line with fluctuations in earnings. This will require up-to-date information about employment and pension income so that claimants' welfare payments can be adjusted to reflect their circumstances. RTI will contribute to the delivery of this.

SPDS

7.5 The SPDS provides an alternative to standard PAYE for non-business employers. It dates from when PAYE was first introduced and was intended to offer a simpler system for non-business employers to use, particularly domestic employers or (often) elderly and disabled individuals employing carers. As PAYE has changed over the years, the scheme has not kept pace, meaning that, today, it is no longer as simple to operate as it once was. The closure of the scheme to new employers from 6th April 2012 will mean that all new employers will operate standard PAYE and be able to use HMRC's free payroll software (available to employers with nine or less employees).

Code 0T

7.6 The change made in respect of payments in the form of securities, interests in securities or securities options is intended to simplify the operation of tax codes and more closely align the deduction of tax with the actual

liability. The change ensures that the same tax code is applied to all deductions of tax irrespective of the form of payment made to an employee after the employment has ceased, where it is not included on Form P45.

Securities

7.7 Schedule 11 to the Value Added Tax Act 1994 allows HMRC to require security for the payment of VAT. The amendments made to ITEPA by the Finance Act 2011 give HMRC a similar power where there is serious risk that employers will not meet their PAYE or NICs obligations.

7.8 HMRC requires businesses to provide security where it believes VAT or other indirect taxes are at risk. This is underpinned by a criminal sanction for trading without providing a security where one is required. The Government considers that equivalent risks exist in respect of PAYE and that the same enforcement tools should be available. This supports the Government's priority of a fairer tax system by deterring non-payment of PAYE.

Other changes

7.9 The amendment to Table 10 in regulation 211 of the 2003 Regulations corrects a minor error in respect of the requirements for employers to provide end of year certificates such as P60s. End of year certificates are provided by employers to employees after the end of the tax year, showing payments and tax deducted. These documents are not submitted to HMRC, so a correction is being made to clarify that electronic submission to HMRC is "not applicable". However, employers are still able to provide an electronic end of year certificate to employees provided they use an approved format.

- ***Consolidation***

7.10 There are currently no plans to consolidate the instrument that is being amended.

8. Consultation outcome

RTI

8.1 HMRC have consulted widely on RTI and the responses to these consultations have been used to inform and develop our policy. The first discussion document was published in July 2010 with a subsequent consultation document published in December 2010. These documents are available at <http://customs.hmrc.gov.uk/RTIConsultationDocuments>. In total we had approximately 600 responses.

8.2 In accordance with the Government's Tax Consultation Framework, a draft of these Regulations was published on the HMRC website for comment from 14th November 2011 to 9th January 2012 together with draft CIS and

NICs regulations. The draft regulations and accompanying technical note are available here: <http://customs.hmrc.gov.uk/ConsultationDocumentsregs>

8.3 There was one significant change as a result of the consultation. The draft regulations proposed the introduction of a leaver statement, to be given to employees when they left a job in place of Form P45. Following representations received and discussions held with representative bodies, it was agreed that the introduction of a leaver statement would be deferred and these Regulations have been amended accordingly.

8.4 All other consultation responses have been considered and HMRC will provide a written response to each representation.

SPDS

8.5 Discussions have taken place informally with employer taxpayer groups concerning the need to close the SPDS and the outcome confirmed our understanding that the scheme is far from simple to operate and there is no significant difference in the operation of the scheme compared to standard PAYE.

Code OT

8.6 Discussions were held with employers and representative bodies concerning the change to the tax code relating to payments in the form of securities, interests in securities or securities options. A draft of these amendments was also published on the HMRC website for comment from 19th January 2012 to 16th February 2012. Questions and answers were also published in support of the draft amendments, and these will be amended and re-issued to address the comments received. The draft regulations and technical note are available here: <http://www.hmrc.gov.uk/drafts/tax-code-change.pdf>

Securities

8.7 The introduction of this power was the subject of consultations by HMRC on 9th December 2010, containing draft primary legislation and draft regulations. A summary of the responses was published to each consultation and is available at: <http://www.hmrc.gov.uk/about/security-payee-nics.htm>

8.8 Following the consultation no changes were made to the primary legislation. The draft regulations were amended, taking account of comments received, in particular, to ensure that employers are made aware of the possibility of managing their debts to HMRC via Time to Pay arrangements at the time a security is required. A response document was published on 31st March 2011.

8.9 The Regulations also include a number of drafting adjustments compared to those consulted on to ensure they operate as intended and for the sake of clarity.

9. Guidance

9.1 Extensive guidance will be published on HMRC's website for employers that join RTI.

9.2 Questions and answers have been provided to employers and share scheme administrators advising when to deduct tax using code 0T on payments in the form of securities, interests in securities or securities options that arise following an employee leaving employment.

9.3 HMRC will publish operational guidance in respect of securities on 5th April 2012 on the HMRC internet site.

10. Impact

RTI

10.1 All employers including charities or voluntary bodies will be required to use RTI. It is expected that there will be a reduction in administrative burdens resulting from abolition of some current reporting requirements. However these savings will be partially offset by the new requirements for employers to collect and submit information each time employees are paid.

10.2 The impact of RTI on the public sector is the same as for any other employer.

SPDS

10.3 Closing the SPDS to new employers will have no impact on the voluntary sector.

10.4 When the SPDS is closed to new employers they will be required to operate standard PAYE. The Basic PAYE Tools free payroll software will be available for all employers with 9 or fewer employees to use. HMRC recognises this may prove difficult for some who employ staff to provide them with care and support. These employers will be given the option to submit their returns by paper to HMRC.

10.5 Closing the SPDS will have no impact on the public sector.

Code 0T

10.6 Employers operating employee share schemes, the payroll software industry and share scheme administrators or any other entities which make share-based payments liable to PAYE are likely to be affected from 6th April 2012.

10.7 There is no impact expected on charities, voluntary bodies or the public sector.

10.8 Tax Information and Impact Notes covering the changes in this instrument relating to RTI, the SPDS and Code OT will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

Securities

10.9 The impact on business, charities or voluntary bodies is not expected to be significant.

10.10 The impact on the public sector is anticipated to bring a cost saving as requiring a security can be cheaper than alternative debt enforcement measures.

10.11 A Tax information and Impact Note covering securities was published on 9th December 2010 alongside draft legislation and is available on the website <http://www.hmrc.gov.uk/budget-updates/autumn-tax/tiin910.pdf>. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

RTI & SPDS

11.1 The legislation applies to small business.

11.2 RTI aims to reduce administrative burdens for all employers, including small employers (upon whom the current burden of PAYE currently falls disproportionately). The aim is to achieve this by integrating employee payment and reporting to HMRC into a single payroll process.

11.3 Small employers are already required to submit returns to HMRC electronically, but those who do not currently use payroll software are expected to find the move to RTI most difficult. However, HMRC's existing free Basic PAYE Tools software will be updated and available for all employers with 9 or fewer employees to use.

11.4 This software will also be available for employers unable to use the SPDS.

11.5 A number of small firms are taking part in the RTI pilot and HMRC's research into employer impacts. The resulting findings will inform the support HMRC needs to offer to small employers to migrate on to RTI.

Code OT

11.6 Few small businesses are likely to operate the types of share schemes that will be affected by this tax coding change.

Securities

11.7 These Regulations are only likely to affect those firms employing up to 20 full time employees where they pose a significant risk of failing to pay their PAYE to the Exchequer. To exclude them would not meet the policy objective.

12. Monitoring & review

RTI

12.1 RTI will be piloted from April 2012 and HMRC will monitor and review these Regulations alongside that pilot and make amendments where necessary.

SPDS

12.2 We will continue to work with taxpayer representative bodies to monitor employers affected by the closure of the SPDS to better understand the impact on affected employers.

Code OT

12.3 We continue to monitor the operation and administration of PAYE and communicate with taxpayer groups affected by this change .

Securities

12.4 This power will be reviewed by an implementation oversight forum which has a majority of external members.

13. Contact

The following can answer any queries regarding the instrument:

RTI and SPDS

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PAYE code applied to share based payments

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Security for Payment of PAYE and NICs

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