

8.7 Taxation - PAYE, NI and Pensions

Introduction

Under current delegation and in accordance with Section 2 of the Scheme, schools are responsible for the payroll arrangements for their employees. There is a need to have an understanding of the Pay as You Earn (PAYE) system, National Insurance and pension systems. Unless schools wish to carry out this specialised function themselves, it will involve the selection of a service provider to provide an effective payroll system and ensure that all legal requirements and contractual obligations for income tax, National Insurance and pensions are met.

The responsibility for having a PAYE scheme and making deductions is that of the employer; but for this purpose the employer is the “person” paying emoluments. Therefore the responsibility is with the LA if it is making salary payments, even if the staff are, for other purposes, employed by the school’s governing body. This is the case with voluntary aided or foundation schools where the LA carries out the payroll.

The school is responsible for a PAYE scheme and making deductions if the payment is made from an account, which is not a “sub account” of the LA and the administration is contracted out to a payroll service under arrangements approved by the Chief Finance Officer.

Income Tax

Income tax and National Insurance contributions (NIC) are separate. Nevertheless, in an attempt to minimise the administrative burden placed upon the employer, both are collected by Her Majesty’s Revenues & Customs (HMRC).

The essence of the PAYE system is that, by the use of code numbers for each individual employee and tax tables which operate cumulatively, the tax due at each pay date is a proportion of the tax which is expected to be due for the year.

Section 19 of the Income and Corporation Taxes Act 1988 specifies that under Schedule E of the UK method of collecting tax, income tax is charged on emoluments earned from any office or employment. Generally, the tax is due on a current year basis and is usually collected by the PAYE method of collection. The employer is obliged to collect income tax on a PAYE basis.

National Insurance Contributions (NIC)

The National Insurance system is founded on the concept that members of the community provide against risks on a community-wide basis. An essential feature is that all contributions should be held in separate fund and that all benefits or claims should be met out of that fund. The contributory scheme includes amounts due in respect of the earnings of employees and there are two types of contribution:

- (a) Employee's contributions - the contribution due is calculated on total earnings if they exceed the lower earnings limit. The amount due is calculated on a fixed percentage between the Lower Earnings Limit and an Upper Earnings

Limit. For any earnings that are in excess of the Upper Earnings Limit the contributions are calculated at 1%. The contributions are deducted at source before the employee receives pay and are paid directly to the HMRC.

- (b) Employer's contributions - these are due from the school in its capacity as an employer of its staff. They are payable to HMRC on the total earnings of the employee if they exceed the lower earnings limit. There is no upper limit for employer's contributions.

PAYE and the Use of a Payroll System

The obligation to collect income tax and National Insurance contributions will be fulfilled by operating an effective payroll system. Generally, a payroll system is used to calculate, from details of gross salaries and tax codes, the amount of income tax and NI contributions to be deducted before the payment of employees' net salaries. Deductions made under the PAYE system, together with the employer's N.I. contributions for the calendar month, are due to HMRC by the 19th day of the following month. The payroll system may be an in-house computer package, or the services of a payroll bureau.

PAYE Forms

The list below shows the most important forms used in the operation of PAYE:

- P6** Notice to employer of tax code or amended code for an employee, used by Tax Office
- P11D** Return of expenses payments and benefits for certain employees
- P14** End of year return of pay, tax, National Insurance contributions
- P30(Z)** Remittance card for monthly payments by employer to Collector
- P35** Employer's annual summary of tax and National Insurance deducted from each employer
- P45** Part 1 - Particulars of employee leaving, sent by old employer to Tax Office
Part 2 - Particulars of old employment, retained by new employer
Part 3 - Copy of Part 1, sent by new employer to Tax Office
- P46** Particulars of any new employee, for whom no code has been notified to employer, sent by employer to Tax Office
- P60** Employer's certificate of pay and tax deducted, given to employee at the end of the tax year.

Benefits-in-Kind and Expense Payments

All employers are responsible for supplying details of benefits received by staff through their employment and also expenses paid to staff. Details of expenses must be recorded irrespective of whether the amounts are ultimately taxable, unless there is a dispensation.

All dispensations from recording benefits-in-kind and expense payments must be made in writing and are only acceptable on terms agreeable to HMRC. The most common form of dispensation covers travelling and subsistence reimbursements to staff.

For each individual employee, a record of benefits-in-kind and expense payments must be completed on form P11D (unless all expenses are covered by dispensations granted by the Inland Revenue), depending on the amounts of earnings in the tax year. Failure to comply may result in significant financial penalties.

Payroll Records Prepared During the Tax Year

Records must be kept for all full or part-time employees showing for each individual their gross pay, tax code, deductions and net pay. Pay for the purposes of PAYE includes not only salaries, wages and overtime, including holiday pay, but many other types of payment. Payments would include, for example, round sum expense allowances.

Payroll Records Prepared at the End of the Tax Year

For the tax year to 5 April the school (unless the LA is providing the payroll service) is responsible for completion of PAYE documentation and forwarding it to HMRC. This includes a list of income tax and NIC deducted from each employee for the tax year, with declaration that all employees have been correctly accounted for and that income tax and NIC deductions are in order. The declaration to HMRC is made on the P35 - employer's annual statement of deductions certificate.

For each individual employee an end of year return of income tax, NIC, Statutory Sick Pay (SSP) and Statutory Maternity Pay (SMP) is completed in triplicate. Two copies (P14) are sent to the local Inspector of Taxes, of which one is passed to the Department for Work and Pensions. The third copy (P60) is given directly to the employee.

All returns, except P9D and P11D forms, must be submitted to the Inspector of Taxes by 19 May following the tax year. The P9D and P11D forms are to be submitted by 6 July following the tax year. There are significant financial penalties for late submission.

Pensions - employers responsibility

Teachers

The Teachers' Pensions Regulations make it clear that the Local Authority (LA) is deemed to be the employer for pension purposes. The LA is accountable from 1 April 1999 for the fulfilment of pension-related employer functions in respect of all schools maintained by them. In essence this means that LAs become responsible for sending monthly contribution payments, annual salary and service returns and appointment and leaver notifications to Capita – the Teachers Pension Agency.

The responsibility also covers payments of AVCs to Prudential. This does not affect the employer/employee relationship in Foundation and Voluntary Aided schools.

Under the Scheme the LA has the power to require schools to abide by financial procedures including those in respect of salaries and pensions. Where the LA is forwarding contributions, but payroll services are provided to the school in question by an external agency, the LA is entitled to require that the specification for the agency's services include provision for LA audit access. This needs to be of an

extent sufficient to provide assurance that the correct level of contributions is being paid to the LA.

Non Teachers

Schools funded by LB Barnet are “scheduled bodies” within the Barnet pensions fund under the Local Government Pension Regulations and are obliged to operate the requirements of the scheme for these staff. The school’s payroll service will be responsible for making the correct payments to the L B Barnet pension scheme unless the employee has opted for private pension arrangements.

Selection of a Payroll Service

Choosing a payroll service is no different from many purchasing decisions where a number of financial and non-financial factors have to be investigated and evaluated. Schools considering an external payroll provider must comply with guidance given on purchasing procedures in this guide including Contract Standing Orders for Schools. One key element of the process is that where the value of the contract is in excess of a value set, a school is required to obtain two competitive written quotations.

Apart from the cost of the service the following issues are relevant considerations –

1. Is the possible contractor able to meet the requirements of the Scheme as set out in sections 2.3 and 3.2 Option B?

2. has the possible contractor:

- Substantial experience of payroll administration, including knowledge of the conditions of employment and statutory obligations of teachers and other school staff,
- Knowledge of Teachers and Local Government pension schemes?

3. Does the possible contractor currently hold contracts for school payroll administration and can they offer suitable referees for the school to contact direct?

4. does the possible contractor offer:

- Verification of proposed pay details by school prior to each payroll run
- Presentation of payroll data classified by staff groups relevant to LB Barnet accounting codes to facilitate budget monitoring and payroll checking,
- Completion of statutory and voluntary returns,
- Supply of standard forms for the provision of data to contractor,
- Acceptance of authorised data only from school,
- Contingency arrangements re computer failure?

5. Schools may also be interested in:

- Facilities for advice and/or training of school staff (telephone, written or visits),
- Provision of supplementary management information,
- Confirmation to the school of earnings re mortgage and other status enquiries,
- Secure and controlled systems re employees personal data.

Whilst under the Scheme, schools are not prohibited from undertaking their own payroll administration, schools considering in-house provision must ensure that they are not being exposed to undue risk of failure to fulfil its legal requirements and contractual obligations to staff. Schools need to take into account many of the issues raised above in relation to the use of a payroll bureau and the following:

- Total costs of in-house provision against cost of an external provider
- Competency and knowledge of person employed to carry out payroll operation
- Arrangements for the payment of payroll in the absence of the member of staff usually charged with this responsibility
- Arrangements for the payment of payroll in the event of computer failure (the operation of a manual system of payroll administration is not considered to be efficient use of resources).

When considering the approval of the payroll arrangements (under section 2.3 of the Scheme), the Chief Finance Officer will seek assurance that the arrangements enable the school to discharge its legal and contractual obligations in an accurate and reliable manner. Also to supply the LA with all necessary information on a timely basis.

Payments to Individuals/Self-Employment Status

All payments to **employees** for work done must be made via the school's Payroll Provider to ensure compliance with PAYE. However, payments to individuals deemed to be a **contractor or self employed** for work done can be made direct from the school Budget Share Account (that is - without any deductions for Income Tax & NI).

Under the current income tax regulations, responsibility for deciding if someone is deemed a contractor or employee, (& hence whether or not to operate PAYE) rests with the engager [responsible officer in school].

Whether someone is deemed a contractor or an employee is a matter of judgement for the engager – not a matter of opinion of the individual. An engager who fails to comply with the Regulations may be liable to pay any income tax and NI contributions that should have been deducted, but were not, due to PAYE not being operated. Therefore schools need to make an informed judgement based on the terms and conditions of the engagement.

An employee will usually be: -

- subject to control (i.e. what is to be done, where and when)
- part of the schools organisational structure / Establishment list
- provided with the equipment & materials necessary for them to do their work
- unable to provide a stand-in to do the work on their behalf (i.e. they will have to do the work personally)
- paid on the basis of hours worked

An individual reporting to be a contractor / self-employed will usually: -

- be in business in their own right
- may be VAT registered
- be providing services to the school, rather than working for the school
- will hold their own public liability insurance
- will supply their own tools, equipment, transport and materials
- may work on their own premises
- have the right to provide a stand-in to do the work on their behalf
- be paid for completion of a set task as distinct from the time worked

In looking at the terms of engagement it is not uncommon to find pointers towards both employment and self-employment status. If overall, the facts indicate employment then PAYE must be operated and in the majority of cases the school should be able to reach a decision on the individual's employment status.

HMRC have devised an on-line tool to enable engagers to establish by means of a questionnaire whether an individual is self-employed or should be treated as employed and PAYE operated.

[HMRC ESI Tool](#)

Key points on the use of the tool -

Employment Status Indicator - ESI

The Employment Status Indicator (ESI) tool enables you to check the employment status of an individual or group of workers - that is, whether they are employed or self-employed for tax, National Insurance contributions (NICs) or VAT purposes.

Who can use the tool

The ESI tool is helpful for anyone who takes on workers, such as employers and contractors. (The tool refers to anyone in this position as an engager.) Individual workers can also use the tool to check their employment status.

However, the tool can't be used to check the employment status of some workers:

- company directors and other individuals who hold office
- agency workers
- anyone providing services through an intermediary (sometimes referred to as IR35 arrangements)

How the tool works

The ESI tool is completely anonymous, so no personal details about the worker or engager are requested.

The tool will ask you a series of questions about the working relationship between worker and engager. If you have a contract setting out the terms of the relationship, it will be useful to have it to hand.

When you start using the tool, your enquiry will be assigned a ten digit ESI reference number (look for it in the top left of the screen). Write this down because you can use it to resume your session later if you don't complete all the questions in one go. The tool automatically saves your progress when you close it, and you have seven days to continue from where you left off.

The ESI result

When you've answered all the questions, the ESI tool will provide an indication of the worker's employment status. You can rely on the ESI outcome as evidence of a worker's status for tax/NICs/VAT purposes if both of the following apply:

- your answers to the ESI questions accurately reflect the terms and conditions under which the worker provides their services
- the ESI has been completed by an engager or their authorised representative (if a worker completes the ESI tool the result is only indicative)

However, you should print or save copies of the 'Enquiry Details' screen and the 'ESI Result screen', bearing the ESI reference mentioned above. If the worker's employment status is questioned in the future, HM Revenue & Customs will only be bound by the ESI outcome if these copies can be produced.

If the school is still unable to reach a decision or having done so it is disputed by the individual, then the school should contact their HR/Payroll provider for guidance.

It is important that the school ascertains the employment status of the individual **prior** to issuing an order or making any form of agreement. This safeguards the school's position and should avoid a dispute with the service provider as he or she can be advised that deductions for tax and NI will be made should they be deemed an employee.

If the school judge the individual to be an employee, any non labour costs can be reimbursed direct with a cheque from the Budget Share Account – providing the individual submits separate invoices for labour charges and non-labour costs. The invoice for labour charges will need to be paid via the Schools Payroll Provider to ensure PAYE is affected.

Exceptions

The only exceptions to the policy of relating the employment status to each individual contract are external trainers and peripatetic music teachers for which there is a dispensation. These may be treated as self-employed if the individuals so wish (and therefore paid gross by cheque). See detail of the exception below.

- Through a dispensation given by the Inland Revenue (ESM4504), individuals who perform work for the school on no more than a total of three days during three consecutive months in any twelve month period or provide an unlimited number of public lectures may be paid gross, i.e. no PAYE/NI deductions will be made from the payment.

- The dispensation is granted primarily to cover external individuals who give one-off lectures or appear as a guest speaker at conferences or seminars.
- The individual must declare these payments from the school on their personal taxation return and ensure that all taxation is properly accounted for.

Financial Guide for Schools
Section 8.7 Taxation – PAYE, NI and Pensions