

## **PAYE tax code applied to payments to ex-employees after form P45 issued**

### **Background**

From 6 April 2011 the default tax code employers are required to operate on a payment made to an ex-employee after their P45 has been issued has changed from code BR (20% Basic Rate) to 0T (zero T) on a non-cumulative (Week 1/ Month 1) basis.

Examples of these payments include final payment of salary or wages, holiday pay, week in hand payments, bonuses, arrears of pay and the taxable element of redundancy payment.

Ideally, additional payments should be made before the P45 has been issued. By doing this, the employee's usual tax code will be operated when the tax deduction is made, and as a result the employee will suffer a deduction of tax that is correct at that point in the tax year. However, HMRC recognise that in some cases it is not always possible for a final or additional payment to be made before the P45 has been issued.

Under the Basic Rate tax code significant underpayments arose for many higher (40%) and additional (50%) rate taxpayers and presented HMRC with compliance issues and customers with underpayments at a later date.

Under code 0T W1/M1, tax is recovered at the basic, higher and additional rates of tax as appropriate. Where the additional payment is being made outside of the normal payroll run the tax code operated on the additional payment will not result in the right amount of tax being deducted in all cases. However, code 0T does in general bring the individual closer to the correct tax due figure when the year as a whole is reconciled, and protects both the exchequer and the individual from potentially large underpayments at the end of the tax year.

### **Share schemes**

Although this change of tax code operated remains good in the majority of circumstances, HMRC were made aware that the operation of tax code 0T W1/M1 could present share scheme administrators and share scheme holders with serious challenges.

Shares held in employer share schemes are valued at the date of leaving, but disposal is not necessarily at the same time, and there can be a time lag between the employment ending and the realisation of the value of shares to meet any tax liability that may arise. In addition, share scheme trustees are required in certain circumstances to dispose of sufficient shares to meet any necessary PAYE liability. The mechanics of this disposal, when coupled with the operation of 0T, means that it is possible that some Basic Rate individuals may have their shareholding reduced to cover a PAYE liability at higher and even additional rates that turns out to be higher than the final tax due. However even if they do eventually get a tax repayment they would not be able to acquire the shares at equivalent value at the date that realisation was required to meet the 0T liability.

Because of this HMRC decided that employers and share scheme administrators should continue to operate the Basic Rate tax code on share related payments.

### **Codes BR and 0T**

Where a final payment is made, and that payment has been made after the P45 has been issued, and is a combination of a share scheme realisation and a payment after leaving, employers should operate code BR (W1/M1) on the share scheme element and code 0T (W1/M1) on the remainder of the payment.

In terms of what code should be entered on the P14, it should be the code that related to the final transaction. HMRC recognise that where a final payment of this nature is paid (combination of a share scheme and a 'normal' payment), and is in the same tax period, it may cause some employers and software developers with some difficulties, because some software packages will only allow for one tax code to be operated in any one tax period.

HMRC apologises for any difficulties caused regarding this and is committed to working with employers, share scheme administrators and payroll software developers to review how this issue is best addressed.