

PAYE underpayments and overpayments

HMRC will be sending out up to five million letters between May and October 2012 to taxpayers who have either paid too much or too little tax under Pay As You Earn (PAYE) in 2011-12. This briefing provides information about how PAYE underpayments happen and what to do about it.

How underpayments and overpayments happen

The PAYE system aims to deduct the right amount of tax from people during the course of the tax year and is based on information that employees and employers provide to us.

PAYE takes the right amount of tax from around 85 per cent of people. But for those who move in and out of work, have fluctuating income, or have expenses and benefits, PAYE deductions do not always equal the tax due. This is largely because the tax affairs for this group of taxpayers can change in-year and the changes may not be reported to us until some time after the event. This means that in any tax year around 15 per cent of taxpayers have paid too much or too little tax.

At the end of each tax year, we check whether customers within the PAYE system have paid the right amount of tax. If too much or too little tax has been paid a tax calculation, on form P800, will be produced and sent to the customer. This is part of the normal PAYE process and has happened each year since PAYE was introduced in 1944. It is known as End of Year Reconciliation (EoYR).

How we will collect underpayments and refund overpayments

This year we plan to:

- start the EoYR process for 2011-12 this month (May), which is two months earlier than last year
- process overpayments and underpayments together, rather than as separate phases, which means the overall EoYR process will be completed earlier.

Customers who have paid too much tax in 2011-12 will start to receive tax refunds sooner. Those customers with more tax to pay will start to receive notifications four months earlier than last year, to help them plan their finances further in advance. In the vast majority of cases, we will collect the additional tax owed when a customer is paid at source, by altering their tax code. This process is known as 'coding out' and will take place during 2013-14.

At this stage, we are still calculating how many underpayments and overpayments are due, but we expect there will be between 2.1 million and 3.5 million customers who have paid too much tax, and between 1.2 million and 1.6 million customers who have paid too little tax. Customers who do not complete Self Assessment tax returns and owe less than £50 will not have to pay anything. The average repayment to customers who have overpaid their tax is £379 and those customers who have paid too little will need to pay an average £537 shortfall.

There were also a small number of customers in 2010-11 who received a refund for overpaying tax, but were told shortly afterwards by us that they had underpaid tax in the same year. This happened because their circumstances had changed in the intervening period and we were unaware of the change before the reconciliation process started. As a result, we are matching this information to accounts more quickly this year, so we can reduce the number of these cases as much as possible.

Giving help to those who cannot afford to pay

In some cases we know making repayments over 12 months could cause some taxpayers financial difficulty. We will be as flexible as possible, so that people can ask to pay the tax they owe by spreading the payment over a maximum of three years if they need to.

Taxpayers wanting more information about Time to Pay arrangements should call the contact number on the letter they receive, quoting their unique reference number. There is also an address on the letter where they can write to us. Where a taxpayer makes a payment arrangement with us, we will not charge interest.

What we are doing to improve PAYE

Real Time Information (RTI) for PAYE is on track as the next stage in modernising PAYE. Under RTI, employers and pension providers will tell us about PAYE payments at the time they are made – as opposed to the current annual end-of-year reporting system. RTI will allow us to keep some customers' tax more up to date in year, as it will be notified more quickly when people change jobs or move in and out of work. Over time, RTI will help ensure we collect the right amount of tax and National Insurance from more individuals during the tax year, meaning fewer customers will be over or underpaid at the end of the year. The RTI pilot was launched in April 2012 as the first step in moving towards the system being fully operational by October 2013. More than 100,000 employee records have been successfully received by HMRC since ten volunteer employers joined the pilot. An additional 310 employer schemes will join the pilot in May and June.

To find out more

Visit our website at www.hmrc.gov.uk/payinghmrc/problems/cantpay.htm