

Payroll

Payroll is a crucial part of your operations. The government requires you to collect tax and National Insurance (NI) under the PAYE system, and imposes penalties for failure and missed deadlines.

The many complications include processing statutory sick pay, statutory maternity pay, pension contributions and personal details such as personal loans and student loans. But few employees will tolerate being paid late or incorrectly.

This briefing explains:

- The functions every payroll has to perform.
- How to manage your payroll.
- The pitfalls.
- How to use payroll information to improve your business.

1 The rules

You must operate a payroll once you have employees. At its simplest, payroll calculates and produces payslips.

1.1 Register with your PAYE tax office directly or contact the New Employer Helpline (0845 60 70 143).

- They will issue you with a PAYE reference and a starter pack. The starter pack gives advice on creating a payroll and operating tax and NI for the first time.

1.2 You must keep basic payroll **information** for each employee. You will need the following pieces of information:

- Determine if an individual works under a contract or service (employee) or contract for services (subcontractor/self employed).
- Each employee must supply you with a National Insurance number. This will be shown on the employee's NI card or P45.
- You need to know the rate of pay for the pay period, when an employee is paid and the date the employee started working for you.
- The employee's P45 will indicate the employee's tax code and details of pay-to-date and tax-to-date from previous employment. Employees without a P45 must fill out form P46 or provide you with the necessary information. You must keep a record of where the information came from if your employee does not complete a form P46.

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You will have to send HM Revenue & Customs (HMRC) a P46 when your employee's earnings reach the Lower Earnings Limit, which is currently £90 a week, £390 a month or £4,680 a year.

- Most employees come under National Insurance category A. Other categories apply for employees who belong to an occupational pension scheme,

PAYE deadlines

The payroll department will usually be responsible for meeting a number of important deadlines.

A There are deadlines for making payments.

- Tax and NI contributions must be paid to your HMRC accounts office by the 19th of each month. Employers who expect to collect less than £1,500 a month in PAYE, NI and student loan repayments may pay quarterly in January, April, July and October.

B Certain forms must be filed at the end of each tax year.

Forms can be filed with your PAYE tax office or online at www.hmrc.gov.uk.

- Form P14, detailing each employee's total pay and tax and NI deductions, must be submitted by 19 May.
- Form P35 is also required by 19 May. This includes a summary of all your P14s.
- Form P11D, for all employees who earn more than £8,500 a year listing the expenses and benefits provided to each employee during the year, has to be filed by 6 July. Employees earning less than £8,500 are given form P9D.

C Employees still working for you at the end of the tax year must be given certain documents:

- Each employee must receive Form P60, detailing their total pay and tax and NI deductions, by 31 May.
- They must be given a copy of form P11D or P9D, showing any taxable benefits received and their cash equivalents, by 6 July. These include all expenses and benefits that do not appear on payroll.

certain types of stakeholder pension schemes, and people over retirement age.

1.3 Keep a list of all wage payments on form P11 or equivalent. A payroll software program will automatically prepare the equivalent.

A P11 is a working sheet to help you calculate:

- The tax due from each employee. This is based on gross pay including basic pay, bonuses, commission, overtime, maternity pay, paternity pay, adoption pay, sick pay and any other taxable pay the employee is entitled to.
- The amount of NI to be paid by the employee and the employer.

1.4 There may be additional deductions from your employees' pay, including:

- Contributions to occupational or stakeholder pension schemes.
- Holiday pay schemes.
- Student loan repayments.
- Union subscriptions.
- Loan repayments.
- Attachment of earnings orders.
- Corrections to previous payslips.

You must not make other deductions from an employee's wages unless you have obtained prior written consent from the employee.

1.5 Issue a P45 to leavers.

- This states gross pay and taxes paid to date.

2 Setting up a payroll

When setting up or upgrading your payroll function, start by establishing your requirements.

2.1 When will your employees be paid?

- It is easier to pay employees monthly. Most employees are paid in arrears, towards the end of the month.

2.2 How many employees do you have?

- The number of employees you have determines how long it will take you to prepare a payroll.

2.3 What payment method should you use?

- Direct credit through your bank is both

inexpensive and reliable.

- Cheques are simpler for a smaller payroll. Your employees must have bank accounts.
- Avoid making cash payments. Paying with cash involves additional work, poses a security risk and increases your bank charges.

2.4 You need a policy regarding **additional payments**. All businesses must have policies on maternity, paternity, adoption and sick pay.

- Who will notify the payroll department of the need for these payments?
- Will you make payments above the statutory minimum?
- What discretion are you prepared to exercise?
You can ask the payroll department to keep track of any absences.

2.5 Establish a **notification procedure**.

- Put somebody in charge of telling your payroll department when people join or leave the company.
- Most companies require an employee's immediate supervisor to notify the payroll department of any sick pay, maternity pay, paternity pay, adoption pay, overtime, commissions, bonuses and unauthorised absences.
- Set deadlines for employees and managers to submit their claims for payments such as overtime and expenses.
Missed deadlines mean that any extra payments owed are paid next time.

2.6 You can be fined for overlooking **taxable benefits**.

- Some benefits are taxed as an addition to gross pay. Most are reported separately on Form P11D. Payroll needs to know the appropriate treatment method for different benefits and the cash equivalent. There are special rules regarding company cars and the provision of fuel.
- You may be able to ask HMRC for a dispensation that will excuse you from reporting certain business expenses.
- You will have to come to a PAYE settlement agreement if you want to pay the taxes on the benefits that your employees receive.
- Some benefits are specifically exempt from tax.
For example, you can spend up to the recognised £150-a-head limit on Christmas parties for your employees without being taxed on it.

3 Operating payroll

3.1 Small businesses may choose to operate payroll manually.

- You have to manually calculate PAYE tax, NI contributions, statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay.
- You can use a 'payroll calculator' to do these calculations.

3.2 Most businesses choose to **automate** the payroll function.

You can choose between two options. For many businesses, the decision depends on the amount of detailed control they wish to have and on whether or not they have the resources to implement an in-house system.

- You can use computer software to establish your own in-house system.
- You can use the fully-managed service offered by an accountancy firm or a payroll bureau (see **3.4**).

Accountants can be expensive but should be the most flexible solution.

3.3 Payroll software provides greater control and the opportunity to capture valuable management information (see **4**).

- The initial cost of implementing a computerised payroll can be slightly higher. The final cost depends on the number of employees and the level of integration you demand.

3.4 A bureau can offer a continuous service to even the smallest of firms.

- You provide the pay data and the bureau produces the payslips, keeps the records and produces the monthly and annual returns.
Some bureaux provide you with terminals so you can directly input the data.
- Most bureaux charge per payslip.
There is an initial fee to set up the payroll and additional fees for any changes you may wish to make.

4 Using payroll information

A well run payroll system can provide you with a range of management information that can be helpful in the running of the business. But only gather the information you will use.

4.1 Payroll information can give you detailed,

accurate data on **employee costs**.

- For example, you can use data from the payroll to calculate exactly how much time your employees spend on different projects. To do this, you will need to establish a system for time recording.
- You can also find out how much you provide in benefits.

4.2 Payroll information can be used to keep track of **individual employees** and their costs and attendance records.

Useful information to monitor includes:

- Holidays taken and remaining.
- Authorised and unauthorised absences.
- Pension scheme costs.
- Trade union membership.

4.3 Qualified payroll personnel must be able to **explain** to employees what their payslips mean.

- For example, they should be able to explain new deductions or changes in the rate of taxation.

5 Pitfalls

5.1 Payroll deadlines have to be met whatever happens. You need to make **contingency plans** if you operate an in-house system.

- You need to have at least two employees who can operate payroll, to cover for sickness and holidays. Alternatively, you may want to make arrangements for your accountant to provide emergency cover.
- Make a back-up copy, preferably stored in an off-site location, of all information that is stored on computer.
- Ideally, you should run payroll on a separate computer with its own printer. This minimises any interruptions to the rest of your system and makes payroll more secure.

5.2 Payroll information must always be kept **confidential**. The company has a clear duty to preserve the privacy of individual employees.

- Establish who is allowed to access payroll information.
- Keep all payroll information in a safe place.
- Use password systems to secure computer files.
- Print payslips separately and destroy any test runs.

5.3 Like any other system that pays out money, payroll is vulnerable to **fraud**.

- Try to avoid having one person managing the whole payroll process from start to finish.
- Establish which employees are allowed to authorise payments.
- Actual payments should be signed off by a director or direct supervisor.

6 Getting help

6.1 Call the HMRC **employer's helpline** for further information (08457 143 143).

- They can give you help with checking P45 details, statutory pay tables, NIC tables B and C and contracted-out NIC tables.

6.2 Visit the **HMRC website** at www.hmrc.gov.uk.

6.3 Professional advisers can help you set up a payroll system appropriate to the size and needs of your business.

- Your accountant can advise you on specific matters, such as managing statutory pay or directors' NI.
- The Institute of Payroll and Pensions Management (IPPM) can also offer businesses a wide range of practical guidance (www.ippm.org or 0121 712 1000).

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