Quick guide to payroll

Overview

Payroll is a specialised function, requiring specialised and trained staff.

For decades, it was seen as a simple accounting function. This is no longer the case. It is now a specialist occupation in its own right.

Payroll is the one financial function that cannot be late. It is fast-changing. There are many penalties that can be imposed for non-compliance. There are many provisions that are rarely encountered.

It should be noted that there are some significant changes being made to payroll from 2013.

Functions

The functions of payroll may be summarised as:

- calculating gross pay for all employees,
- calculating statutory payments (such as SSP, SMP etc)
- determining what payments are subject to income tax and national insurance
- calculating PAYE
- calculating national insurance
- making other deductions from pay
- calculating net pay
- making payments to HMRC
- paying the employees
- producing documents for HMRC, employees and the accounts department.

These are the minimum requirements. Payroll may be given other duties.

There must be clear lines of authority, so that payroll knows from whom to accept instructions about an employee starting, leaving, receiving a pay rise, or being entitled to a bonus or commission.

Calculating gross pay

Gross pay must be capable of being calculated exactly and on time.

This will usually be one of the following:

- fixed amount per week or month
- rate per hours worked
- piece rate, an amount per achievement, such as unit assembled.

For an hourly rate or piece rate, payroll must know the amount achieved, such as from a timesheet, clock card or similar document.

If overtime is paid, payroll must know if this at the normal rate or at a premium, such as time and a half.

Where bonuses and commissions are paid, there must be a system to ensure that payroll are notified of the amount.

However the gross pay is calculated, it must comply with the law on the national minimum wage.

An employee paid a fixed amount per month is paid a pro rata amount where the whole month is not worked. Tribunals have generally favoured using working days rather than calendar days, for which purposes holidays are regarded as working days. Such an adjustment may be needed:

- for the month in which the employee starts or leaves
- for any day where the employee is taking industrial action
- for any day of unpaid leave.

Advances on salary

Usually an advance on salary is ignored for payroll purposes.

Suppose an employee normally receives monthly gross pay of £3,000 and net pay of £2,300 after tax and national insurance. The employer agrees to lend him £1,000 partway through the month.

The £1,000 is paid without any deduction of tax or national insurance.

At the next pay run, the payslip is calculated as if no advance had been made, and the sum then deducted from the net figure. So the payslip will show gross pay of £3,000 and net pay of £1,300.

Back pay

Back pay is when a retrospective adjustment is made to a pay rate. An example is an employee given a pay rise from 1 July backdated to 1 April.

Payroll must check for each employee whether that employee has been continuously employed from 1 April, and make a pro rata adjustment if not.

The amount of back pay must be calculated and shown separately on the payslip.

It is treated as an addition to gross pay in the pay period *when paid.* You do not go back and recalculate past payslips.

Allowances and expenses

An allowance paid in cash is almost always treated as an addition to gross pay. It is subject to tax and national insurance.

To the extent that the allowance represents a tax-deductible expense, relief may be claimed. This may be done by the employee where the allowance is reflected in a tax code. Alternatively, the employee may apply to HMRC for a dispensation for it to be paid without tax deducted.

Business expenses that are reimbursed to an employee are usually not treated as gross pay. A refund of a personal expense usually is taxable as gross pay.

The amount of any allowances and expenses is a matter to be agreed between employer and employee. They are free to agree almost anything they wish. Payroll's function is to ensure that tax and national insurance is operated properly.

Benefits in kind

Benefits in kind are things which are provided by an employer but which are not in the form of cash.

Examples include company cars, cheap loans, private medical insurance, social club facilities and the suchlike.

Most of such benefits are subject to income tax and some are also subject to national insurance. However the method of collecting this tax is different.

Instead of deducting tax at source under the PAYE scheme, a form known as a P11D is submitted at the end of each year listing the benefits provided. The employee's tax code is usually adjusted so the employee pays tax on the benefit in the following year.

Net salary

Net salary is calculated by making deductions from gross salary.

The only items that may be deducted from salary are:

- tax and national insurance
- items that the employee has authorised (such as pension contributions, loan repayments or trade union dues)
- student loan deductions
- attachment of earnings orders
- corrections from previous payslips (with exceptions)
- shortfalls in the retail trade.

It is an offence under Employment Rights Act 1999 s13 to make any other deduction from wages *even if the employee owes you money.*

Attachments of earnings orders are made by the courts, local authorities or for child maintenance. A notice is served on the employer requiring sums to be deducted and paid to the body that issued the order.
Mistakes on payslips cannot always be recovered from an employee. If an employee had no reason to believe that he or she was being overpaid and has spent the money, you may not legally be able to recover the overpayment.

Employees in the **retail trade** may have up to their 10% of their wages deducted to cover any loss of stock or cash during their shift. Very few retailers use this provision.

Payslips

Every employee is entitled to a payslip each pay day under Employment Rights Act 1999 s8.

This must state:

- gross pay
- amounts of fixed deductions
- amounts of variable deductions
- net pay
- how it has been paid if more than one method is used.

Most payslips give much more information than this. However, the above is all that an employer is required to state.

Payment of wages

The salary or wages of each employee must be paid in a method agreed between employer and employee.

By far, the commonest method is by bank transfer using BACS. Over 90% of all salaries and wages are paid this way.

Other on-line banking services include CHAPS and Fast Payments Service.

Wages may be paid by cheque or even in cash.