

PAYE Settlement Agreements: fit for the future?

Employment Tax

Personal tax

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With mandatory payrolling approaching, employers should review how their PAYE Settlement Agreements, data and processes will work in practice.

Key Points

What is the issue?

PAYE Settlement Agreements remain valuable, but unclear boundaries, complex calculations and inconsistent administration can create uncertainty. The move to mandatory payrolling from April 2027 makes the interaction between the two regimes increasingly important.

What does it mean to me?

Employers need to understand what their existing PSAs cover and ensure that data,

calculations and evidence are robust. They must also prepare for mandatory payrolling and decide which benefits may appropriately remain within a PSA.

What can I take away?

Review existing agreements, identify relevant data sources and test exemptions before grossing up. Clear records of sampling, assumptions and tax rates will remain important, while employers should ensure PSA planning forms part of their wider payrolling preparations.

PAYE Settlement Agreements (PSAs) perform a very important function. Where a taxable employee benefit or expense is minor, irregular or impracticable to allocate and report through normal payroll processes, a PSA allows the employer to settle the income tax together with Class 1B National Insurance contributions (NICs). This means that employees don't face an unexpected tax charge and payroll teams are not forced to recreate individual-level historic data on minor benefits.

In June 2026, HMRC published a Call for Evidence on 'PAYE Settlement Agreements' as part of a wider review of how PSAs operate in practice. The review, which closed on 15 September 2026, asked how employers use PSAs, how they decide what to include in them, and whether the rules are clear, consistent and fair. The review is not intended to change the underlying taxation of benefits and expenses, but its timing is thought provoking, with mandatory payrolling of benefits fundamentally changing the way benefits are reported from April 2027.

A 'quick poll' on PSAs, carried out on 18 August 2026 by the Chartered Institute of Payroll Professionals (CIPP), found that 72% had an active PSA, while 31% reported that their PSA had been in place for more than ten years. This suggests that many agreements were negotiated before today's working patterns, reward structures and employee expectations developed, and that they may not cover current benefit structures adequately.

Any changes to PSAs should preserve their flexibility, clarify the rules and recognise that real-time reporting increases the value of a year-end settlement route where reliable data is not available by the payroll cut-off date.

Unclear boundaries

The Income Tax (Earnings and Pensions) Act (ITEPA) 2003 ss 703–705 and the Income Tax (Pay As You Earn) Regulations 2003 Part 6 provide the framework, but the terms ‘minor’, ‘irregular’ and ‘impracticable’ require judgement based on historic HMRC practice rather than clear principles. That is uncomfortable where tax, NICs and penalties are at stake, particularly as Guidelines for Compliance 13 (GfC13), on ensuring that documents and returns are correct and complete, and proposed new ‘requirement to correct’ powers for HMRC increase the focus on filing certainty.

What does ‘minor’ mean? The term is subjective and may cover small overnight expenses or low-value non-cash gifts. The boundary with the statutory trivial benefits exemption is particularly unclear: a benefit costing £50 or less may be exempt if all conditions are met, while an item failing those conditions may nevertheless be ‘minor’ for PSA purposes.

‘Irregular’ is also open to interpretation, but ‘impracticable’ creates the greatest tension. HMRC suggests that normal reporting should be considered where recipients and costs can be identified. Yet theoretical traceability is not the same as a workable process: badge data may identify attendees at an event but not what each person consumed.

The rules can also produce different outcomes depending on whether the same privately used item is bought directly, paid for by corporate card or voucher, or reimbursed. That form-over-substance distinction is difficult to justify.

Employers need current examples and consistent HMRC decisions to give them certainty.

The need for active management

A PSA generally continues until it is amended or cancelled, but an enduring agreement is not a self-maintaining one. Many agreements were drafted before current wellbeing programmes, hybrid working and digital reward platforms existed. ‘Staff entertaining’, for example, may not clearly cover virtual events or employee networking activities, while broad wording can encourage the assumption that anything similar is covered.

HMRC introduced an online service in 2023 through which employers and agents can apply, amend or cancel their PSA – a clear improvement. However, an authorised

user still cannot see the operative agreement, amendment history, submitted computations, liabilities and payments in one place. For employers with several PAYE schemes, that is a significant control weakness and administrative burden.

Timing adds to the problem. The agreement must be in place by 5 July following the tax year, but employers may identify a category late or wait for HMRC to approve revised wording. The route to regularisation is then unclear, with similar facts sometimes producing different outcomes simply because applications are reviewed by different HMRC officers.

A redesigned service should offer a standard digital agreement, selectable categories, status tracking and an audit trail. National service standards and escalation to specialists would improve consistency, while a defined route is needed for late-discovered items.

The decisive issue: data

Preparing a PSA starts with tax analysis, but the hardest work is usually finding and validating the data. Potential items sit across accounts payable, expenses systems, corporate cards, reward platforms, event budgets and overseas ledgers and can include thousands of lines of data. Ledger narratives may be poor, exemptions may not have been considered at source and population data may be unavailable by the time the annual exercise begins.

The calculation then asks for distinctions that the original record was never designed to capture. Employers may need to separate Scottish, Welsh and other UK taxpayers, allocate costs across marginal rate bands, distinguish employees from guests and consider internationally mobile employees. Where the reason for using a PSA is that precise attribution is impracticable, demanding perfect employee-level data is contradictory.

HMRC's Guidelines for Compliance recognise the use of sampling and the importance of record keeping. Following the guidance can reduce, although not remove, enquiry risk. However, there are still no clear parameters for acceptable estimates, extrapolation and materiality.

In the meantime, employers need to be able to distinguish reliable approximation from weak control. Clearer HMRC parameters on sampling methods, acceptable

headcount or attendance data and subsequent adjustments would help them to do so, as would guidance on how employers should retain evidence of sources, exclusions, assumptions, tax rates and ledger reconciliation.

Calculation complexity

A PSA is expensive because the employer pays the employee's tax and that payment is itself taxable. The grossed-up tax is then included, with the original benefit, in the Class 1B NICs base. Where several rates apply, each population must be separated by tax rate and grossed up separately (there are currently six chargeable income tax rates in Scotland), so weaknesses in data or assumptions are magnified.

The treatment of employees below the personal allowance shows how uncertainty can arise. HMRC requires employers to include all employees who received the benefit, including those earning below the personal allowance. Where an employee pays no tax with the employer, HMRC guidance requires them to be included at their first chargeable rate for PSA calculation purposes. This raises a wider question: how far should an employer-level settlement be expected to reflect individuals' precise tax positions?

The annual process is also disconnected from the employer's PAYE account. HMRC recommends submission by 31 July, a non-statutory deadline, with payment due by 22 October electronically (or 19 October otherwise). If HMRC does not receive a PSA calculation, it may make a determination under the Income Tax (Pay As You Earn) Regulations 2003 reg 110 based on estimated figures, potentially resulting in a liability higher than the employer's own calculation.

In practice, some employers have encountered suggestions from HMRC that missing the non-statutory deadline should result in a voluntary disclosure.

While HMRC provides an online method to submit a PSA calculation, it is built around manual inputs from the user. HMRC could instead provide a standard calculation template or structured upload, automatic checks and a digital acknowledgement linked to a visible liability. A single payment reference should follow the submission.

The priority should be consistency: clear rules for mixed populations, nil-rate cases, rounding and estimation.

Mandatory payrolling

From 6 April 2027, real-time reporting of income tax and Class 1A NICs will replace Form P11D reporting for company cars, car fuel, vans, van fuel and employer-provided medical benefits. The precise scope of each category is not yet clear, meaning that employers preparing early will be forced to make assumptions. Most remaining benefits are due to follow from April 2028, while loans and accommodation remain voluntary for now.

This is not simply a matter of replacing a P11D with a payroll data item. Employers will need taxable values before payroll cut-off, rapid notification of joiners, leavers and benefit changes, and robust corrections. Employees will see the tax effect in their take-home pay, making late or volatile adjustments much more visible. In my experience, even a technically correct design can fail if HR, reward, finance and payroll do not operate as one process.

Unlike mandatory payrolling, where tax on a benefit is collected from the employee through payroll, a PSA allows the employer to bear the tax on qualifying items. PSAs should remain available where the statutory conditions are met, including where a cost cannot be valued or attributed reliably before payroll closes. Guidance must prevent double reporting and explain how to make corrections where an item moves between payroll and the PSA.

Payrolling also raises timing issues. Amendments to PSA categories must be agreed with HMRC by 5 July after the end of the tax year. This deadline made sense when a benefit not covered by a PSA could instead be reported on Form P11D by 6 July. Under mandatory payrolling, why not allow employers longer, potentially until the statutory PSA payment deadline of 22 October, to capture all relevant items in their PSA?

Special cases also need to align. HMRC has indicated that globally mobile employees may be voluntarily excluded from mandatory payrolling from April 2027 and remain within year-end P11D processes. Third-party benefits and items identified after an employee leaves also complicate a real-time model. PSA reform cannot sensibly be designed in isolation from these cases.

Practical reforms

Any changes to the PSA rules should create a clearer settlement regime that reflects why employers use them. HMRC should prioritise the following issues:

- **Clearer boundaries:** HMRC should publish a decision framework linking exemptions, payrolling, P11D reporting and PSA treatment, supported by worked examples that explain how the rules apply in practice.
 - **Proportionate safe harbours:** The rules should offer simplified treatment for low-value or genuinely communal provision, with thresholds reviewed and updated periodically to avoid outdated cliff edges.
 - **End-to-end digital administration:** Employers and agents should be able to view and amend agreements, submit calculations, validate figures, see liabilities and payments, correct errors and manage multiple PAYE schemes through a single service.
 - **An evidence standard:** HMRC should set clear expectations for sampling, estimates, and apportionment.
 - **Outcome-driven tax treatment:** The rules should avoid disparities in tax treatment arising solely from the form in which payment for the same benefit is made.
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What employers should do now

HMRC's PSA review is not a reason to pause. Employers should take the following steps:

- Review the wording and scope of their enduring agreements rather than rely on institutional memory.
- Map potential PSA items to source systems, data owners and payroll deadlines.
- Test exemptions before grossing up, and document sampling and tax-rate assumptions.
- Reconcile the final population and expenditure to the ledger.
- Check historic nil returns or missing calculations in light of HMRC's determination activity.
- Decide which items will be payrolled, which may remain within a PSA and who is responsible for late decisions.

PSA governance should also form part of mandatory payrolling readiness. Benefit providers must supply timely data, while employee communications should distinguish tax borne by the employer from tax collected through pay.

In conclusion

PSAs remain valuable because benefits do not always fit neatly into individual payroll records. HMRC should judge any changes against one practical test: can each taxable benefit be reported once, accurately and through the most proportionate route? Clear boundaries, accepted evidence standards, simpler calculations and an integrated digital account would meet that test. Requiring more employee-level data regardless of cost or reliability would not.