



HM Revenue
& Customs

Employee Benefits and Expenses – exemption for paid or reimbursed expenses

Consultation document

Publication date: 18 June 2014

Closing date for comments: 9 September
2014

Subject of this consultation:	Replacing the dispensations regime with an exemption for qualifying expenses that are paid or reimbursed by employers.
Scope of this consultation:	To explore the details of the proposed exemption, including: <ul style="list-style-type: none"> • how employers can be given certainty about record keeping requirements; • how the exemption can be protected from abuse; • whether and how bespoke scale rates can be used under the exemption; • how the exemption should be introduced and over what timescale; • whether transitional rules are needed; and • what guidance HMRC needs to update ahead of it's implementation.
Who should read this:	The Government is interested in hearing from everyone with views or an interest in this subject including employers who currently have a dispensation or pay expenses, professional/ representative bodies, agents, payroll providers, and software developers.
Duration:	The consultation will run from 18 June 2014 to 9 September 2014
Lead official:	Travis Woodward, HMRC
How to respond or enquire about this consultation:	Responses to the consultation can be e-mailed to the following address employmentincome.policy@hmrc.gsi.gov.uk . Alternatively written responses may be sent to the Employment Income Policy Team, Room 1E/08, 100 Parliament Street, London, SW1A 2BQ.
Additional ways to be involved:	Meetings with external representatives will be arranged. If you are interested in attending such a meeting to put forward your views please make contact using the details shown above. If you require the text of this consultation document in Braille or Welsh then please use the contact details above.
After the consultation:	The Government will publish details of the consultation representations and its response at Autumn Statement 2014. This will also include any decisions made by the Government regarding this policy change in light of the responses received.
Getting to this stage:	This consultation is one of four being run by HMRC and HMT in response to the interim and Final report of the Office of Tax Simplification reports into employee benefits and expenses <ul style="list-style-type: none"> • Interim report • Final report <p>More information on the other consultations can be found online at: https://www.gov.uk/government/publications/employee-benefits-in-kind-and-expenses-an-update</p>

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On request this document can be produced in Welsh and alternate formats including large print, audio and Braille forma

Foreword

This consultation represents the next step in taking forward some of the recommendations made by the Office of Tax Simplification following the excellent work they carried out in the review of employee benefits and expenses. The Government believes that the legislation we will introduce as a result will deliver real simplifications that improve businesses' and individual's experience of the tax system.

It is important that we get the structure and detail of this legislation absolutely right, so each of the consultation documents provides the Government with the opportunity to learn from those who will be directly affected. We want to hear from you so that we can draw on your experience and suggestions for the practical implementation of our proposals. That will ensure better legislation is implemented which is one of this Government's key objectives



David Gauke

Exchequer Secretary to the Treasury

1. Introduction

- 1.1 At Budget 2014 the Chancellor announced a number of measures aimed at simplifying the administration of employee Benefits in Kind (BiKs) and expenses. This followed the Office of Tax Simplification (OTS) review of employee benefits and expenses¹.
- 1.2 The announcement included a core package of four measures for consultation with a view to introducing legislation in Finance Bill 2015.
- 1.3 The core package consists of the following changes:
 - Abolishing the threshold for the taxation of BiKs for employees who earn less than £8,500 a year ('lower paid' employments), with action to mitigate the effects on any vulnerable groups disadvantaged by the reforms;
 - Introducing a statutory exemption for trivial benefits;
 - Introducing a system of voluntary payrolling for BiKs; and
 - Replacing the expenses dispensation regime with an exemption for paid and reimbursed expenses.
- 1.4 A separate consultation document is being published on each of these changes and consultation on all four will run for 12 weeks from 18 June to 9 September 2014.
- 1.5 The Chancellor also announced a review of the rules on travel and subsistence. This will launch later this summer and aims, over the longer term, to develop a set of rules that are clear and straight forward to use for employers, and are flexible enough to cater for 21st century working patterns.
- 1.6 As also announced at Budget 2014 a call for evidence on remuneration practices in the 21st century will be published alongside these consultations, seeking evidence to inform future policy development.
- 1.7 This document covers the proposal to **replace the expenses dispensation regime with an exemption for expenses paid or reimbursed by employers** and seeks views on the detail of how that exemption should operate and be implemented. HMRC welcomes views from employers, employees, tax agents and professionals, representative bodies and software providers.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OTs_employee_benefits_final_report.pdf

Note to the reader

- 1.8 For the avoidance of doubt it should also be noted that, even though this document mainly refers to expenses payments, where appropriate this should be read as including the provision of BiKs which qualify for tax relief under the rules for employee expenses.

2. Background

Current tax rules

- 2.1 When employees incur qualifying expenses² in the course of the duties of their employment they are entitled to relief from income tax. This relief is given in the form of a deduction from their earnings from that employment.
- 2.2 Where an employer pays or reimburses a qualifying expense to their employee they are required to report that payment to HMRC at the end of the year on form P11D (and the employee must still make a claim to HMRC to receive their tax relief) unless that employer has a **dispensation**.
- 2.3 A dispensation is an agreement between an employer and HMRC that allows the employer to pay specified expenses to their employees without having to report them to HMRC, and without having to deduct tax and National Insurance contributions (NICs). This in turn means that employees receive the tax relief they are due without having to make a claim to HMRC.
- 2.4 Employers must apply individually to HMRC for a dispensation listing the expenses that they wish to be included. They must also have adequate systems or processes in place to check that the expenses they wish to include in their dispensation qualify for tax relief, and that their employees are actually incurring those expenses in the first place. In many cases this means that the employer must periodically check the records and receipts of their employees.
- 2.5 Employers can apply for a dispensation by sending a form P11DX to HMRC.

National Insurance contributions and expenses

- 2.6 Employers are not required to deduct NICs from expenses payments that are made under a dispensation (which mirrors the tax treatment of such payments). However, for expenses payments made outside of a dispensation the NICs rules are different.
- 2.7 Whereas for tax purposes an employer must report the expense payment on form P11D, for NICs the employer must determine for themselves whether or not they are required to deduct NICs from the payment, or whether they should “disregard” it. There is no requirement to report expenses payments for NICs purposes.

² Examples of expenses that qualify for tax relief include travel and subsistence expenses incurred on qualifying business journeys, certain professional fees and subscriptions, and other general expenses that are incurred wholly, exclusively, and necessarily in the performance of an employee’s duties.

Office of Tax Simplification

- 2.8 The Government launched the Office of Tax Simplification (OTS) on 20 July 2010 to provide the Government with independent advice on simplifying the UK tax system. During 2013 the OTS carried out a review of Employee Benefits and Expenses, and published their findings and recommendations in January 2014.³
- 2.9 One of the chapters of the OTS's report examined the issues with the current rules for employers paying expenses to their employees, including the use of dispensations. It also explored the proposal of replacing the dispensations regime with a more straight forward exemption for paid or reimbursed expenses.
- 2.10 Some of the main challenges that the OTS highlighted with the current system were that:
- for employers and employees without a dispensation the process of the employer reporting the expense to HMRC on P11D and then the employee having to separately claim tax relief is burdensome, especially given that the net result is often that no tax is due;
 - dispensations can quickly become outdated as circumstances change and employers wish to pay different expenses, but the process for updating them can be slow in practice;
 - dispensations may provide employers with a false sense of security, as they may believe that the granting of a dispensation means that HMRC is confirming that their expenses checking systems/ process are adequate, which is not the case;
 - many smaller or unrepresented employers aren't aware that they can apply for a dispensation, or else can find the concept of a dispensation confusing;
 - the items requested to be included in a dispensation can vary between employers, leading to inconsistencies in the tax treatment of expenses by different employers; and
 - there is a concern among employers that HMRC can be inconsistent in the expenses it agrees for inclusion in a dispensation, leading to some employers being able to negotiate overly generous dispensations.

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OTs_employee_benefits_final_report.pdf

2.11 In response to these challenges the OTS recommended that the Government replace the dispensation regime (and the requirement to report expenses paid outside of a dispensation) with a more straight forward exemption for qualifying expenses, which would allow employers to determine for themselves whether an expense payment is taxable or not. They also highlighted that this proposal would put all employers on an equal footing.

2.12 The OTS identified a number of factors which will need to be considered as part of the design of the new exemption. These included:

- the need for clearer HMRC guidance on expenses;
- whether withdrawing dispensations would result in a loss of assurance for employers that they are applying the correct tax and NICs treatment to payments;
- whether the new exemption should apply to all employers or whether it should be opt-in (with those who don't opt in continuing to return P11Ds);
- the need for clarity on the checking and record keeping requirements that employers must follow;
- whether different rules should apply to micro companies (i.e. very small or one-person companies); and
- whether the exemption needs to be protected against being used in conjunction with salary sacrifice arrangements.

2.13 These and other considerations are explored in more detail later in this document.

3. The Exemption

Effect of the proposed exemption

- 3.1 As announced at Budget 2014, the Government accepts the OTS's recommendation of replacing the current dispensation regime with an exemption for allowable expenses that are paid or reimbursed by employers.
- 3.2 This means that employers would no longer be required to choose between applying to HMRC for a dispensation and reporting expenses payments to HMRC. Instead all employers would need to determine themselves whether the expenses they pay are subject to tax relief or not, and treat them accordingly.
- 3.3 This proposal would remove the current disparities that exist at both employer and employee level where one employer has a dispensation and another does not, along with any differences caused by employers having different expenses included in their dispensations.
- 3.4 The Government also believes that this change would reduce administrative burdens for employers, both in removing the need to apply for and update dispensations, and also in removing the need for employers to complete form P11Ds for qualifying expenses not covered by a dispensation. This in turn would increase the flexibility of employers to adapt to any changes in the expenses they pay their employees.
- 3.5 This change would also mean that all employees would automatically get the tax relief they are due on qualifying expenses payments, instead of just those paid under a dispensation.

Scope of the exemption

- 3.6 The Government intends the exemption to apply to all qualifying expenses paid or reimbursed by an employer. An expense will qualify if the employee would have been eligible for tax relief on that expense had they met the costs themselves.
- 3.7 It is not the Government's intention for this measure to in any way change the rules that determine whether or not tax relief is available for expenses incurred by employees – the proposed exemption is intended only to simplify the way in which employees receive that tax relief when their expenses are paid or reimbursed by their employer.
- 3.8 The Government proposes that the exemption should cover all employers who make expenses payments, and should not be 'opt-in'. The Government feels that much of the potential simplification for employers could be lost if the exemption were made 'opt-in', in particular the fact that the two different regimes would need to exist side-by-side, which is the cause of much of the complexity in the current system.

- 3.9 The Government also does not see that there would be any benefit to employers not opting in to the exemption, as they would still be responsible for determining whether the expenses payments that they make should be disregarded for NICs purposes. This would mean that those employers would have both the responsibility for getting the treatment of the payments right and the administrative burden of reporting the expenses for tax purposes.
- 3.10 Therefore the Government is proposing that the exemption should apply to all employers without any option to opt in or out.

Employer responsibility

- 3.11 As set out in chapter 2, the OTS felt that there would be a risk that some employers currently draw a sense of security from their dispensation, and therefore may feel that the proposed exemption would place a greater responsibility on them to ensure that the expenses they pay to their employees qualify for tax relief.
- 3.12 The Government does not believe that the proposed change will place any greater responsibility on employers than that which currently exists. Under a dispensation it is already the employer's responsibility to ensure that expenses are only paid free of tax and NICs if they meet the terms of their dispensation, and that their employees are genuinely incurring those expenses.
- 3.13 The Government acknowledges that some employers may nevertheless feel that they have lost some degree of assurance from no longer having a list of expenses that HMRC have confirmed should attract tax relief.
- 3.14 However there are steps HMRC can take to ensure that employers remain confident in the tax treatment of the expenses they pay to their employees, such as improving HMRC's guidance (see paragraph 6.9 onward).

4. Assurance

Record keeping

- 4.1 Currently where an employer has a dispensation it is the employer's responsibility to ensure that the expenses they pay are in line with the terms of their dispensation, and to keep records that demonstrate this. Where an employer pays their employees a scale rate⁴ in respect of an expense the employer must perform sufficient checks to satisfy themselves that their employees are actually incurring those expenses, and must keep a record of those checks.
- 4.2 There are many different types of records that could be kept and checking processes that could be followed that would satisfy those requirements, and different ones will be suitable for different employers.
- 4.3 It is the Government's intention that these requirements will broadly remain in place under the new exemption. It is also the intention that employers should continue to have the flexibility to keep the records and follow the checking processes that are most suitable for them.
- 4.4 However there is a trade off between providing this flexibility and providing employers with certainty that they are taking reasonable care that they are operating the exemption correctly and keeping sufficient records to evidence this.
- 4.5 This potential lack of certainty may mean that some smaller employers place a larger than necessary administrative burden on themselves, either because they assume the record keeping requirements are more restrictive than they are, or because they are unsure of what they should retain and so err on the side of caution.
- 4.6 One way that the Government could provide certainty for employers is to provide one or more 'models' of acceptable recordkeeping and processes for checking employee expenses, setting out details such as:
- the documentary evidence to be retained and checked;
 - how long that evidence should be retained for;
 - the frequency and nature of the checks to be performed;
 - the number or proportion of employees to be checked;

⁴ A scale rate is an amount that an employer may pay to their employees instead of paying or reimbursing the actual amount of the employees' expenses – see Chapter 5 for more information.

- the evidence that can be accepted from an employee that they incurred the expense; and
- the action that should be taken when an employee fails to retain appropriate evidence.

4.7 However, setting out such models could lead to employers feeling that any other approaches to record keeping and checking will be unacceptable, which would not be the intention.

Q1: If the Government were to provide ‘models’ of acceptable record keeping and checking processes would this be helpful for employers? Where the models are not appropriate for employers, would those employers feel disadvantaged, even if it is made clear that they are not exhaustive?

4.8 If the Government were to provide employers with ‘models’ for acceptable record keeping and checking processes, there are two main ways that this could be achieved: through HMRC guidance or through secondary legislation in the form of regulations.

4.9 If these ‘models’ were included in regulations then employers may feel that this would give them greater certainty that, if they follow the model, their record keeping and checking processes would be acceptable to HMRC. However including these models in regulations would also make them harder to update and would necessarily be less flexible than is possible in guidance.

4.10 The Government therefore does not intend to provide these ‘models’ through secondary legislation.

4.11 Alternatively, if the models were included in guidance then it would be easier for HMRC to keep them relevant and up to date. It would also allow the models to be slightly less prescriptive, allowing flexibility for employers to adapt them slightly to their own needs while still being able to state to HMRC that they are following the model. This would be the Government’s preferred approach.

4.12 While some employers might feel that the models would not give them as much certainty as including the requirements directly in regulations would, this concern could be addressed by ensuring that the guidance is as clear as possible.

Protection against abuse

4.13 The Government is aware of a number of arrangements that are used by a minority of employers which seek to replace taxable pay with payments of non-taxable expenses. Historically these arrangements have involved employees sacrificing an amount of their salary in exchange for being paid an equivalent amount of subsistence expenses. The primary purpose of these arrangements

is usually to reduce the amount of NICs that the employer is required to pay. The arrangements are often aimed at low paid employees.

- 4.14 Because these arrangements reduce an employee's taxable pay there are a number of potential side effects for an employee taking part in them, including a potential reduction in the employee's entitlement to contributory benefits due to reduced NICs payments by the employee. These issues predominantly affect the lowest paid workers. In many cases employees are given no real choice but to participate in these arrangements.
- 4.15 There is also a commercial effect to such arrangements. Those employers who use these arrangements have a reduced NICs liability and, as a result, they gain a competitive advantage over employers who are unable or unwilling to enter into similar arrangements themselves.
- 4.16 The majority of these arrangements involve the expenses payments being made under a dispensation.
- 4.17 The Government does not believe that these arrangements are in the spirit of the rules that provide relief for employees who incur qualifying expenses in the course of their work. The Government also does not believe it is fair that employers who enter into these arrangements gain a competitive advantage over those employers who seek to operate within the spirit as well as the letter of the law.
- 4.18 The proposed exemption provides an opportunity for the Government to tackle some of these arrangements and prevent them being used in the future. This would most likely be achieved through a targeted anti-abuse rule to prevent such arrangements being used in conjunction with the exemption.
- 4.19 The Government's intention is that any action to tackle these arrangements should not disturb any legitimate business practices that are not tax or NICs motivated. While the Government is not aware of any commercial reason for these arrangements, other than a desire to reduce tax and NICs liabilities, it would welcome views on whether there are any business practices that would be inadvertently affected.
- 4.20 In particular the Government would welcome views on whether there are specific types or models of these arrangements which are not tax or NICs motivated. Similarly views would be welcome on whether there are types of these arrangements which are clearly contrived or artificial.

Q2: Are you aware of any types of arrangement that seek to replace taxable pay with payments of non-taxable expenses which the Government should focus on in particular when tackling this issue? Are you aware of any types of these arrangements where tackling them might disturb business practices that are not tax or NICs motivated?

5. Scale rates

Current scale rate process

- 5.1 As well as normal expenses payments dispensations can also include one or more **scale rates**. A scale rate is an amount that an employer may pay to their employees instead of paying or reimbursing the actual amount of the employees' expenses.
- 5.2 In order for HMRC to agree to include a scale rate in a dispensation the employer must show that the scale rate is no more than a reasonable reimbursement of the average qualifying expenses that their employees incur. This normally means that employers must conduct a sampling exercise of the expenses payments that they make to their employees.
- 5.3 Alternatively, instead of carrying out a sampling exercise, employers have the option of using the HMRC **benchmark scale rates**. The benchmark scale rates are 4 rates that can be included in a dispensation to be paid in respect the cost of food and drink that employees incur while on an allowable business journey.
- 5.4 The current scale rates are:
- a "Breakfast" rate of £5;
 - a one meal, or 5 hour, rate of £5;
 - a two meal, or 10 hour, rate of £10; and
 - a late evening meal rate of £15.
- 5.5 An employer may apply to use the benchmark scale rate without having to demonstrate to HMRC that their employees incur those levels of expenses on average. However the employer must still fulfil their obligations with regards to checking that their employees are actually incurring allowable expenses, as with any other expenses included in a dispensation.
- 5.6 An employer may also choose to apply to HMRC to include a custom scale rate in their dispensation. In order to support the level of the scale rate applied for the employer must conduct a sampling exercise. This involves the employer checking a sample of all relevant expenses claims made by their employees over a given period (usually one month) and using this data to indicate the average amount that their employees incur on that particular type of expense.
- 5.7 It is the administrative burden of carrying out such a sampling exercise that led to the introduction of the benchmark scale rates in 2009. Only a very small proportion of all dispensation applications received each year request a custom scale rate – although exact figures are not available HMRC estimate that fewer than 1% of new applications request a custom rate.

Q3: In what circumstances would an employer currently apply for a custom scale rate? Other than the expenses covered by the benchmark scale rates, which expenses do employers commonly request a scale rate for?

- 5.8 In addition, HMRC has anecdotal evidence that some employers request the inclusion of a scale rate in their dispensation unnecessarily. This occurs where employers use a scale rate as an upper limit to the amount of expense that they will pay to their employees.
- 5.9 While there is nothing to prevent employers from doing this, they do not actually need to include a scale rate in their dispensation to do so.

Using custom scale rates under the exemption

- 5.10 As custom scale rates are currently agreed as part of the dispensation application process, under the proposed exemption there would be no natural opportunity for an employer to agree a new custom scale rate with HMRC.
- 5.11 There are a number of ways that the proposed exemption could deal with this challenge, including:
- not permitting the use of custom scale rates under the exemption (but possibly broadening the range of benchmark scale rates to include any expenses for which custom scale rates are often requested);
 - retaining an application process solely for custom scale rates that are to be used under the exemption; and
 - allowing 'Self-certification' of custom scale rates by employers, with clear rules on the sampling exercise that must be conducted to support those rates.
- 5.12 Not permitting the use of custom scale rates has some attractions in terms of achieving the Government and the OTS's goals of providing simplicity for employers. Given the low take-up of custom scale rates (and the fact that it is not clear how many employers actually use those rates as scale rates, rather than as a cap) there is a clear argument against retaining this complexity for the benefit of only a small number of employers.
- 5.13 However, it is also possible that there are employers for whom their custom scale rates are invaluable, and removing them could result in a significant additional administrative burden on those employers. Some of this additional burden could be removed by expanding the benchmark scale rates, but likely not all of it.

Q4: Are there any examples of particular industries or types of employer who would be affected if custom scale rates could not be used with the proposed exemption? What would the impact be on those employers?

- 5.14 Retaining a process for employers to agree custom scale rates with HMRC would clearly allow those employers who find such scale rates helpful to continue to obtain and use them in the future. However, the Government would of course need to balance the need and demand for such a process from employers against the cost of providing such as service.
- 5.15 There is also potentially a risk that the awareness among employers and agents of such a process would be low, as not many employers would regularly make use of it based on the current numbers of employers applying to use custom scale rates. Equally, efforts to promote awareness of the existence of this process could be potentially confusing to employers who would otherwise have been content to either use the benchmark scale rates or to not use scale rates at all.

Q5: Would employers be disadvantaged if a process to apply for custom scale rates were not retained? If such a process were retained, would it be seen as additional complexity by those employers who do not need it?

- 5.16 It is the Government's intention that any custom scale rates permitted in the future will still need to be supported by a sampling exercise by the employer.
- 5.17 Allowing employers to 'self-certify' a custom scale rate by carrying out a sampling exercise in accordance with clear rules on how that exercise should be conducted could allow employers to retain the flexibility to use custom scale rates, but without the need to go through an approval process, and without the need for HMRC to process applications.
- 5.18 However, there are a number of potential risks to this option. The additional rules required to detail the sampling exercise the employer would need to run and the records that they would need to keep to support it would clearly add complexity.
- 5.19 Employers may also be uncomfortable with the possibility of a later compliance review finding fault with the sampling exercise and concluding that the rate of the scale rate arrived at was incorrect. However this could be mitigated to some extent by clearly setting out rules for the sampling exercise in regulations or guidance to provide employers with certainty, although this may have the consequence of reducing flexibility for employers.

- 5.20 Self-certification of custom scale rates would make it harder for HMRC to identify and assist those employers who might need help in correctly conducting a sampling exercise. It would also make it harder for HMRC to identify if an employer had carelessly or deliberately overstated/ manipulated their sampling data to support a higher scale rate.

Q6: Would employers welcome the ability to self-certify the sampling exercise undertaken to support a custom scale rate? If so, would a sampling process set out in guidance or regulations provide sufficient certainty for employers that wish to use a custom scale rate?

Micro companies and directors of close companies

- 5.21 One area of risk that currently exists with dispensations is the use of scale rates by one person companies and directors of small, close companies. This is because it is often difficult for those employers to demonstrate that there has been any independent checking that the director is actually incurring allowable expenses.
- 5.22 The Government is also aware that some of the schemes mentioned above that aim to replace some of an employee's salary with expenses payments involve setting up each employee as the director of their own personal service company and then paying the director expenses using a scale rate under a dispensation. For example, the Government is aware that some schemes seek to use this method to circumvent regulations that prevent expenses payments counting towards the National Minimum Wage.
- 5.23 It is unclear whether there is a pressing need for one person companies or very small, close companies to be able to pay a scale rate in respect of expenses. For such small employers there can be no real administrative saving from paying a scale rate rather than reimbursing themselves the actual amount of expenses incurred.
- 5.24 In order to protect against potential abuse of the exemption by some small companies the Government proposes that one person companies and directors of small, close companies would not be permitted to be paid a scale rate for expenses under the exemption (but this would not affect those companies paying a scale rate to other employees). However, the Government would like to hear from any small employers who would be affected by this proposal.
- 5.25 In particular the Government would like to understand the reasons very small employers use scale rates, in order to determine whether there should be any circumstances in which these employers should be able to pay a scale rate to their directors.

Q7: What are the reasons for one person companies and very small, close companies paying scale rates to directors in respect of expenses? Would such employers be disadvantaged if they were not permitted to pay scale rates to their directors under the proposed exemption? If so in what way?

6. Implementation and transitional arrangements

Existing dispensations

- 6.1 As mentioned above, the OTS in their report highlighted that some employers may take comfort from their dispensation, and may feel that any removal of that dispensation would result in a loss of assurance.
- 6.2 Although any expenses that are correctly included in a dispensation should also be permitted to be paid under the proposed exemption the Government acknowledges that some employers may feel less certain that the expenses payments they make qualify for relief than they did under their dispensation.
- 6.3 One potential mitigation might be to allow employers with existing dispensations to continue to rely on them for a transitional period. This would allow those employers more time to adapt to the new exemption and ensure that they are comfortable that the expenses included in their dispensation will also be within the scope of the exemption.
- 6.4 However, this would raise a number of questions, such as whether the exemption would still apply to expenses paid by those employers which are not within their dispensation (in which case the employer would be operating the two systems simultaneously, which could be confusing for the employer).
- 6.5 There would also be questions over how long the transition period should be, and whether it should apply to all dispensations or just those agreed/ renewed in recent years.
- 6.6 Overall, while this mitigation may provide employers with additional certainty during the transitional period, it may also be a source of complexity and confusion for employers.

Q8: Would employers welcome being able to continue to rely on their existing dispensation for a transitional period, or would this be a source of unnecessary complexity? Is so, how long would the transitional period need to be to be useful?

- 6.7 If the Government decides not to allow existing dispensations to be used for a transitional period, there is still a case to be made that employers should be able to continue to use any custom scale rates that have been agreed as part of an exemption (assuming that custom scale rates may still be used under the exemption – see chapter 5).

- 6.8 The alternative is that all employers who currently have a custom scale rate in their dispensation and wish to continue to use that rate under the proposed exemption would be required to apply whatever rules are put in place for the agreement of custom rates immediately on starting to use the exemption. This would result in a significant administrative burden for those employers and potentially for HMRC (depending on the rules put in place for setting custom scale rates) at the time the proposed exemption comes into force.

Q9: Independently of whether existing dispensations may continue to be used, would employers welcome being able to continue to use any custom scale rates they had agreed as part of their dispensation for a transitional period? Is so, how long would the transitional period need to be to be useful?

Guidance

- 6.9 One dependency for the proposed exemption that OTS highlighted in their report was the need for improved HMRC guidance on the tax rules for expenses, in order for employers to be confident in the tax and NICs treatment of the expenses that they pay to their employees.
- 6.10 As explained above, the Government does not believe that the proposed exemption places any greater responsibility on employers to apply the correct tax and NICs treatment to expenses payments than the current rules do. However, the Government acknowledges that clear guidance on the tax rules for expenses will be key in employers being confident in using the new exemption.
- 6.11 While there is always room for improvement in all guidance HMRC will need to focus its efforts where they will be of most assistance to employers, and so the Government would welcome views on:
- which parts of the guidance on expenses payments it would be most helpful to update or improve; and
 - specific suggestions or views on how those parts of that guidance could be improved.

Q10: Are there any specific situations or circumstances in which employers would not feel confident paying expenses because of a lack of clarity in HMRC's guidance? Which changes could HMRC make to its guidance that would have the biggest impact on employers' confidence in paying these expenses?

Implementation

- 6.12 The proposed exemption represents a fairly fundamental change to the way that relief is given for expenses payments made by employers. As such the Government is aware that some employers and agents may be concerned about the implications of the exemption being implemented too quickly, before employers, agents, and software providers have had a chance to prepare.
- 6.13 HMRC will also require time to update and improve relevant guidance, and to put any transitional arrangements or new processes in place as necessary.
- 6.14 There are three main options for how the Government could implement this change:
- the exemption could come into effect alongside the legislation, which could be as early as 6 April 2015;
 - the exemption could be phased in over time; or
 - the exemption could come into effect after a suitable period of time following the introduction of the legislation.
- 6.15 Having the exemption come into effect at the same time as the legislation comes into force would mean that the complexities of the current system would be brought to an end as early as possible, and that employers who currently report expenses on form P11D would benefit from the administrative saving immediately.
- 6.16 However, as set out above, there is potentially a great deal of preparation required in order for employers and HMRC to be ready for the exemption to come into force, which is unlikely to be achievable by the start of the next tax year. The Government is also aware that many employers would need time to adapt their processes and IT systems to any change.
- 6.17 The Government is therefore not intending to pursue this option.
- 6.18 The exemption could be phased in over time in a number of ways. This could be by size of the employer, with only smaller employers with simpler affairs being subject to the exemption initially, or by the expenses that are within the scope of the exemption (for example, the exemption could initially only apply to qualifying travel and subsistence expenses, and be extended to other expenses over time).
- 6.19 The Government is not intending to pursue this option either due to the potential increased complexity and confusion of both the old and the new system being in place simultaneously as the proposed exemption is phased in.

- 6.20 The third option for the new exemption would be for the legislation to not come into effect until the start of a later tax year, after the legislation becomes law. This would give employers the certainty of knowing exactly what the new rules would be, and would also allow them time to adapt their systems and processes in preparation for the exemption coming into force. It would also give HMRC additional time to update and improve its guidance to support employers.
- 6.21 However, this option would mean that the complexities of the current system would continue for one or more additional years, and would mean that employers who were considering applying for a dispensation during that period would be faced with a choice. Those employers would have to choose between going through the application process for a dispensation which may be obsolete a short time later, or waiting and having to report all expenses payments to HMRC on form P11D until the exemption comes into effect.
- 6.22 There would also be a potentially difficult interaction with any transitional arrangements, as care would need to be taken that there was no incentive for employers to rush to agree a dispensation with HMRC before the exemption comes into effect.
- 6.23 However, the Government believes that these issues can be resolved, and that a small amount of short term complexity here would be acceptable given the practical difficulties with the other two implementation options.
- 6.24 In terms of the length of time between the legislation becoming law and the exemption coming into force, the Government would want to allow sufficient time for employers and other affected groups (such as software developers) to prepare, but would not want to delay any longer than necessary.

Q11: Would employers and other affected parties welcome the exemption not coming into force for a period of time after the legislation is in place? If so, how long would employers and other affected groups need to prepare for the new exemption coming into force?

Q12: How should dispensation applications that are made in the intervening period be handled?

7. Summary of consultation questions

Q1: If the Government were to provide 'models' of acceptable record keeping and checking processes would this be helpful for employers? Where the models are not appropriate for employers, would those employers feel disadvantaged, even if it is made clear that they are not exhaustive?

Q2: Are you aware of any types of arrangement that seek to replace taxable pay with payments of non-taxable expenses which the Government should focus on in particular when tackling this issue? Are you aware of any types of these arrangements where tackling them might disturb business practices that are not tax or NICs motivated?

Q3: In what circumstances would an employer currently apply for a custom scale rate? Other than the expenses covered by the benchmark scale rates, which expenses do employers commonly request a scale rate for?

Q4: Are there any examples of particular industries or types of employer who would be affected if custom scale rates could not be used with the proposed exemption? What would the impact be on those employers?

Q5: Would employers be disadvantaged if a process to apply for custom scale rates were not retained? If such a process were retained, would it be seen as additional complexity by those employers who do not need it?

Q6: Would employers welcome the ability to self-certify the sampling exercise undertaken to support a custom scale rate? If so, would a sampling process set out in guidance or regulations provide sufficient certainty for employers that wish to use a custom scale rate?

Q7: What are the reasons for one person companies and very small, close companies paying scale rates to directors in respect of expenses? Would such employers be disadvantaged if they were not permitted to pay scale rates to their directors under the proposed exemption? If so in what way?

Q8: Would employers welcome being able to continue to rely on their existing dispensation for a transitional period, or would this be a source of unnecessary complexity? If so, how long would the transitional period need to be to be useful?

Q9: Independently of whether existing dispensations may continue to be used, would employers welcome being able to continue to use any custom scale rates they had agreed as part of their dispensation for a transitional period? If so, how long would the transitional period need to be to be useful?

Q10: Are there any specific situations or circumstances in which employers would not feel confident paying expenses because of a lack of clarity in HMRC's guidance? Which changes could HMRC make to its guidance that would have the biggest impact on employers' confidence in paying these expenses?

Q11: Would employers and other affected parties welcome the exemption not coming into force for a period of time after the legislation is in place? If so, how long would employers and other affected groups need to prepare for the new exemption coming into force?

Q12: How should dispensation applications that are made in the intervening period be handled?

8. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

- Stage 1 Setting out objectives and identifying options.
- Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
- Stage 3 Drafting legislation to effect the proposed change.
- Stage 4 Implementing and monitoring the change.
- Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

How to respond

A summary of the questions in this consultation is included at chapter 7.

If you have any queries or would like to respond to any of the issues raised in this consultation document please send your responses by 9 September 2014, by e-mail if possible to employmentincome.policy@hmrc.gsi.gov.uk

or by post to:

Travis Woodward
Employment Income Policy Team
Her Majesty's Revenue and Customs
Room 1E/08
100 Parliament Street
London
SW1A 2BQ

The consultation will run for 12 weeks from 18 June 2014.

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from [HMRC Inside Government](#). All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: <http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance>

If you have any comments or complaints about the consultation process please contact:

Oliver Toop, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.