Office of
Tax Simplification

Review of employee benefits and expenses: final report

July 2014

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Foreword

This report is the third and – for the moment at least – final report from the OTS on the area of Employee Benefits & Expenses (EBE). In it we report on two particular areas – accommodation benefit and termination payments – and give an update on a variety of smaller matters.

The two main topics are both difficult and sensitive areas. In our EBE interim report we identified them as issues that needed reviewing and suggested some ways forward. We knew we needed to spend proper time on the two areas, so waited until we had published our second report so as to allow a proper focus on them. That also allowed interested parties plenty of time to contact us with views and we have arranged a further series of evidence gathering meetings in recent months. Many of these have been with bodies with particular interests in the accommodation question.

We do think there is scope to improve the current rules for accommodation benefits and termination payments and we point to some ways that both areas can be simplified relatively easily. However, it is clear that real simplification can only come with something of a recast of the rules (particularly on terminations). These clearly require policy decisions and given where we are in the political cycle, these are probably questions for the next government to address. Although that will be disappointing to some, we think it also represents an opportunity for interested parties to make their views known on the ideas we suggest in this report. That will enable HM Treasury and HMRC to evaluate more fully the way forward and present incoming Ministers with appropriate recommendations.

As we noted in our interim report, one consistent message we heard is that these two areas are in need of reform. There are anomalies, inconsistencies and difficulties in practice. Policy is unclear – often set long ago. In both areas, there is a need to make sure that modern working practices and conditions are reflected in the way the rules work.

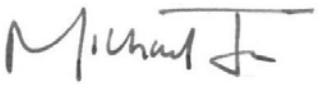
But if there is a general consensus that there is a need to improve the working of the current rules, there is no obvious route as to how to effect that improvement. If there was, it would no doubt have already been taken, of course! We think that we have identified some ways that the rules and systems can be improved fairly quickly and pointed to what we see as the best ways of effecting major reforms, together with the main issues, advantages and disadvantages. As in all of our work, our aim is simplification: rules that are clearer, easier to apply and potentially fairer, though we are equally conscious that we are straying into areas that require policy decisions.

One reason for suggesting that reforms will need time to take forward is that we are aware that these two areas are sensitive ones. There is a perception that changes would impact lower-paid employees. We do not think that has to be the case. Indeed, there is a certain irony that the driver for accommodation benefit is often portrayed as aiming to capture the benefit of an avowedly 'perk' benefit given to a senior executive, whereas most issues are over relatively modestly paid staff. Meanwhile termination payments can hit the headlines when a multi-million payoff is given to someone; yet the average payment is around £14,000.

As always we must conclude with thanks and acknowledgements. We continue to be grateful to the many organisations, groups and businesses who give us their time and views; we could not do our work without them. HMRC and HM Treasury staff have worked with us very constructively and the HMRC Knowledge, Analysis and Intelligence team in particular have provided a great deal of valuable data. We are pleased that we can include as an annex to this report an update from HMRC on their progress on implementing the 'quick wins' identified in our interim report.

But the main thanks go to those on the OTS team who have shouldered most of the work: Tracey Bowler, who has led on accommodation and Suzy Giele who has led on terminations, both of whom have now completed their secondments with us, together with Jayesh Patel who has once again coordinated all our work and the production of this report. Well done all!

We look forward to hearing comments on this report, either direct to us at ots@ots.gsi.gov.uk or via HMRC.



Rt Hon Michael Jack

Chairman

John Whiting

Tax Director

Executive summary

Introduction

This is the third report of the OTS employee benefits and expenses review, following our interim report published in August 2013 and second report published in January 2014. In this report we tackle two important, complex and sensitive areas of the employee benefits system – accommodation benefits and termination payments. In both cases, we identify the problems and causes of complexity, analyse options for change, and propose solutions to make things simpler. We have also revisited some of the miscellaneous employee benefits and expenses items we discussed in Chapter 8 of our interim report.

We have taken time to look at accommodation benefits and termination payments in detail, building on the research undertaken at the interim report stage, with a supplementary round of stakeholder meetings and data gathering. This has provided us with a better understanding of the technical and practical problems caused by these two issues. We have also gathered more data: for instance, we found that the average value for accommodation benefit is about £5,000, and the average termination payment is near £14,000. But we recognise that knowledge gaps still remain. For instance, we do not know exactly how many people are receiving tax free accommodation, or who these people are, as HMRC data (understandably) only records those who are taxed on a benefit. Nor do we know how many people receive statutory redundancy payments compared to non statutory payments.

Knowledge gaps mean we are not able to definitively assess the impact of our recommendations – but we have set out sensible and workable proposals that we believe the Treasury and HMRC can take forward in wider consultations.

Accommodation benefits

We have heard of many problems in this area. There are difficulties defining 'living accommodation' as opposed to, say, 'bed and breakfast' or a few nights in a hotel. There are also difficulties applying the HMRC tests to identify an exemption. For instance, the 'necessary for the proper performance of duties' test is criticised for being too narrow to use, and the 'better performance of duties and customary' test is criticised for being impossible for a taxpayer to apply without knowledge of how other similar taxpayers operate. The customary test causes difficulties and unfairness in practice by being slow to adjust to changing working practices. Another issue is the continued "grandfathering" of occupations that were exempt prior to 1977.

We have now reached a point where the combined effect is a system of rules that are too arbitrary and inconsistent, and difficult to apply. Consider, for example, that the Vice Chancellor of a university who only occasionally uses their accommodation can be exempt from tax on the benefit as it is grandfathered (because it was exempt pre-1977), but a low paid sheltered housing warden cannot receive exempt accommodation because recent changes have removed the requirement for them to be on call out of hours. Both may well be situations that can validly be said to require the employee to utilise that accommodation to do their job: why should there be different taxing results? A system which has reached a point of so many inconsistencies is inevitably complex in practice.

Furthermore, calculating the tax charge is very complicated. Different methods are used depending on if the employer rents or owns the property; if employer owned, a further six elements are considered as part of the calculation:

1 when the property was first made available

2 the rateable value in 1973

3 whether the employee first occupied the property after 30 March 1983

4 whether the employer has held it for more than 6 years

5 whether the property cost plus improvements amounts to more than £75,000

6 the number of employees occupying the property

It is difficult to find a simple and accurate way of identifying 'perk' accommodation, as opposed to accommodation required for the job, that can be easily applied in all cases. Aside from the most basic types of accommodation, we believe that employer provided accommodation is in principle a benefit. The simplest route would be to stop there and tax the value of the accommodation provided. But that would ignore the necessity faced by some staff of living in specified accommodation to do their job. Accordingly, we believe that, as now, exemptions should be available in certain situations. We think the solution is to work to improve this current framework, especially around the main areas of complexity.

This means recommending that the most basic accommodation is taken out of the tax charge entirely. It also means reformulating the existing exemptions with the aim of distinguishing more accurately between what is really a 'perk' and what is needed to get the job done. We have set out in the report key elements to help do this, including:

- whether the employee is required to live in the accommodation to enable him/ her to protect buildings, people or assets;
- whether the employee is regularly required to work outside normal working hours; and
- whether he/ she is required to live in the accommodation as a result of regulatory requirements.

We would hope that it is possible to formulate an exemption which would encapsulate these elements – and replace the current exemptions (including grandfathering).

In particular, we think the "customary" rule in the current legislation needs to be dropped. It is unworkable in practice, and unfair because it favours long established occupations over newer ones.

We also note, as an issue to be tackled in the short term, that the list of jobs which can benefit from exempt accommodation in the HMRC Manuals potentially perpetuates the idea that it is the job title and not the role which is important. We therefore recommend that as a first step before our more fundamental suggestions are pursued, that the HMRC Manual guidance is reviewed to make clear that HMRC consider substantive duties and not job titles. We would encourage consideration being given to the development of a checklist or tool which could help readers assess whether the customary test is met.

With regards to simplifying the calculation of the tax charge, we recommend that all accommodation is taxed on the basis of open market rental value. From the discussions we have had with stakeholders and the Valuation Office Agency, it would appear that in most cases this would be a value that is quickly identifiable, and could be produced easily enough for special cases. Values would be set to have proper regard to factors such as remoteness of the accommodation, public access and wider use. Clearly revaluing properties every year would be a burden for employers, so we would envisage that either an index is applied to the value, or (preferably) the valuation is only required every five years.

This approach is simple and would do away with the current complexity of using 1973 Gross Rateable Values (or 1976 values in Northern Ireland and 1985 values in Scotland). It would also mean we no longer needed the separate charge for "expensive" properties valued over £75,000.

Termination payments

This is an area which gives rise to confusion because many people believe that the first £30,000 of any 'payoff' will be tax-free and are faced with an unpleasant surprise when they find that is not the case. Furthermore, many employers are unclear about which parts of a termination package qualify for the exemption. The result can be that the well-advised benefit from the exemption; those without proper advice frequently trip up.

We believe that payments made in connection with a termination of employment should remain subject to income tax in principle, that certain exemptions should apply, but that these should be designed in a simpler way. We think the simplest way forward is for income tax relief to be only available in circumstances where the employee qualifies for a statutory redundancy payment. We also propose a government review of the existing exemptions, reliefs and reductions for termination payments, in order to establish in each case whether they should be retained as part of the wider reform of income tax and NICs treatment of termination payments.

Under this new relief, we propose that the level of the exemption would be a multiple of the statutory redundancy payment that the relevant individual is entitled to (or alternatively, a flat amount). All payments linked to the termination payment received by the relevant individual (including his/ her statutory redundancy payment) would be aggregated and then the income tax exemption would be applied against the value of these. Subject to this value limit, this relief could extend to any termination payments that he/ she receives – regardless of the nature of the payment.

The proposal would lead to simplification by making it easier to understand the circumstances to which the tax exemption applies (i.e. cases of statutory redundancy). Eligibility would not depend on the terms of the employment contract, as now, which favours the well-advised and can catch people out. Furthermore, there is a recognised statutory definition of redundancy, and a case to suggest that a common approach between employment and tax law is sensible.

There is also a case for reforming the NICs rules around termination payments as part of wider NICs reforms. This could result in payments above the exempt threshold being subject to NICs.

Reforms along the lines we have suggested will help some who lose their job yet find their termination payment is fully taxable; others may currently benefit from a tax-free amount yet do not qualify for statutory redundancy. If Ministers decide to pursue this route, which we believe will be simpler, more data on potential winners and losers will be needed.

Other issues – follow up to Chapter 8 of the interim report

Our interim report published in August 2013 contained a lengthy chapter introducing some twenty five issues that did not warrant a separate chapter or did not fit into the main chapters of the report. Since then, some of these issues have cropped up regularly in meetings with stakeholders, most notably: removal expenses, long service awards, and authorised mileage allowance payments (AMAP) rates. These issues remain to be properly tackled and we think it's important that they do not drop off the radar.

With regards to removal expenses, the current limit of £8,000 (before a taxable benefit is triggered) is outdated. Simplification suggests all removal expenses being 'allowable', balanced with provisions to guard against abuse. At a minimum, excess reimbursed removal costs should

qualify for settlement via a PAYE Settlement Agreement (PSA). With regard to long service awards, a more modern system is needed, more linked to current working patterns.

In relation to a number of the issues in this section, for example entertaining (including aspects of subsistence, staff canteens, etc) we hope that responses to the current HM Treasury call for evidence on remuneration patterns and the forthcoming consultation on Travel & Subsistence will give further evidence of the practical issues to be addressed.

We are conscious that a number of the changes we recommend in this section have a potential Exchequer cost. All have the potential for simplification dividends which will at least partly balance that cost, but revenue implications will undoubtedly be a factor in Ministers' decisions on whether and how to take forward our proposals.

Update on 'quick wins'

Finally, we include as an Annex to this report a welcome recent update from HMRC on the 'quick wins' which we published in our August 2013 interim report.

Many will particularly welcome that HMRC are beginning work on reviewing the content of booklet 490 and are scheduled to have this completed by early next year and published before May 2015. Temporary workplace rules for jobs carried out in phases was a source of problems for some important sectors and they will be pleased that there will be revised guidance published in the Employment Income Manual by the end of September 2014.

One of the quick wins – allowing the tax on home broadband costs to be settled through PSAs – has run up against HMRC's opposition to widening the scope of PSAs. Their response to the OTS's general recommendation for widening the ambit of PSAs in our January report was that such changes would not be consistent with their purpose. However HMRC will consider the case for specific benefits being permitted within a PSA. In the meantime, the OTS continues to make the case for a general widening of PSAs, based on the consistent and loud calls we have heard from employers of the value of such a move – and the potential to save administrative costs yet potentially increase tax revenues.

Next steps

We look forward to receiving ministers' formal responses to this report, possibly in the Chancellor's Autumn Statement. It is clear that our main proposals should undergo a formal consultation process to help the government understand in more detail the impact on revenue, businesses, HMRC processes, and specific groups of winners and losers, together with the need for transitional arrangements.

Whilst the report does include some small scale changes that can be implemented without delay, the main recommendations involve radical change to the present system, and if implemented, would most likely require transitional arrangements and would not be introduced in the immediate future. Ultimately, it is up to the Chancellor and Treasury ministers to decide on how to proceed.

Summary of recommendations in this report

Chapter 1: Accommodation benefits

- That the most basic accommodation is taken out of the tax charge entirely.
- Reformulating the existing exemptions with the aim of distinguishing more accurately between what is really a 'perk' and what is needed to get the job done. We have set out in the report key elements to help do this, including:
    - whether the employee is required to live in the accommodation to enable him/ her to protect, buildings, people or assets;
    - whether the employee is regularly required to work outside normal working hours; and
    - whether he/ she is required to live in the accommodation as a result of regulatory requirements.
- Introducing the use of open market rental value to tax all non-exempt accommodation, and that an index is applied to the value for say 5 years or (preferably) the valuation is only required every, say, 5 years.
- Exploring the need for transitional protection as part of formal consultations about these proposals.
- A general rule that the benefit of the provision of ancillary services other than council tax, water and sewage is tax exempt if the benefit of the accommodation is tax exempt.

Short term recommendations

- That as a first step before our more fundamental suggestions are pursued, the HMRC Manual guidance is reviewed to make clear that HMRC consider substantive duties and not job titles. We would also encourage consideration being given to the development of a checklist or tool which could help readers assess whether the customary test is met.

Chapter 2: Termination payments

- A new income tax relief should be available instead of the current £30,000 exemption under section 403 ITEPA 2003. This relief should only be available in cases of statutory redundancy. Under this new relief, the level of the exemption should be a multiple of the statutory redundancy payment that the relevant individual is entitled to (or alternatively, a flat amount).
- A formal consultation to review the existing exemptions, reliefs and reductions which apply to the charge under section 401 ITEPA 2003, in order to establish in each case whether they should be retained.
- A review of whether there should be a reform to the NICs treatment, so that the treatment of income tax and NICs are better aligned.

Short term recommendations

- That HMRC revisits its position on the circumstances in which a non-contractual payment in lieu of notice (autoPILON) is considered to have been paid, with a view to:
    - relaxing its requirements that a critical assessment needs to have been

made in order for a payment not to qualify as one, and;

- setting out the factors that are relevant in determining whether a payment is a damages payment, taking into account current commercial practices.

- That HMRC guidance is clarified and updated in order to reflect policy on how the exemption section 406(b) ITEPA 2003 (exemption on injury and disability) applies, and that HMRC gives consideration to ways in which its current clearance process may be improved.
- That HMRC carries out a review of the way in which it currently deals with queries on termination payments internally, in order to understand how extensively this issue is raised and how efficiently HMRC deals with such queries, with a view to then carrying out a costs and benefits analysis of having a more dedicated, centralised and publicised team specifically for termination payments queries.
- That HMRC consider whether there is scope to develop better guidance for employers: in simple terms, whether guidance on the website can be made more dynamic so as to reflect current queries, and possibly to offer interactive tools to help employers determine the tax treatment of particular types of termination payments.

Chapter 3: Other items

- Removal expenses: the current limit for removal expenses of £8,000 (before a taxable benefit is triggered) is outdated; simplification suggests that all removal expenses are 'allowable', balanced with provisions to guard against abuse. At a minimum, excess reimbursed removal costs should qualify for settlement via a PSA.
- Long service awards: a more modern system is needed, more linked to current working patterns.
- Entertaining, including aspects of subsistence, staff canteens, etc: here we hope that responses to the current HMT call for evidence on remuneration patterns and the planned consultations on Travel & Subsistence will generate further evidence of the practical issues in this area.
- We also comment on beneficial loans; aspects of cars & car fuel; cycle to work schemes; training costs; transfer/use of assets; subscriptions to professional organisations; and uniform/clothing costs.

1 Accommodation benefits

1.1 The subject of accommodation benefits was identified as an area needing review and updating in our interim report. We heard of many difficulties and inconsistencies with the operation of the rules but it was also clear that this was a complex and sensitive area that needed careful and in depth review. We have therefore built on our initial work in the interim report, speaking to representative bodies about the tax problems encountered when providing accommodation to employees. The additional work has helped to identify in more detail why the current rules and processes are complex and burdensome.[1]

1.2 A list of the main bodies we have spoken to is in Annex E. We have also considered the rules applied in various other jurisdictions which are summarised in Annex C.

Overview

1.3 There are many reasons why employees are provided with accommodation by their employers. Whether this provision is a taxable benefit has been the subject of attention, including court cases, for many years[2]. One issue was that the employee could not normally turn the occupation of the accommodation into money's worth so it was not chargeable to income tax as earnings. In due course rules were introduced to tax employees on the benefit[3]. The basic rule is that living accommodation provided to an employee is taxable and subject to Class 1A NICs.[4] The rules contain exemptions[5] which cover many situations. For those remaining to be taxed, the charge is based on:

- The rateable value if the employer owns the property or rental value if the employer rents it;
- If the employer owns the accommodation and it cost more than £75,000, a further charge applies.

1.4 In terms of issues that appear to cause problems, these fall under three broad themes. We have used these as the basis for many of our discussions with stakeholders:

- What is 'accommodation'...how can this be distinguished from 'bed and breakfast' or a hotel?
- What exemptions apply and how can the wide charge be narrowed down to those who really get a benefit?
- For those who get a taxable benefit, how best to calculate the benefit?

[1] We have not addressed the differences in treatment between employees and the self-employed. We will be addressing the implications of employment status on tax treatment more generally in one of our next projects.

[2] See for example Tennant v Smith 1892AC150

[3] The rules are now in ITEPA 2003 s97 etc.

[4] In addition there is a charge under S62 ITEPA 2003 if an employee can choose whether to receive accommodation or a higher wage. The charge applies to the higher wage. However, we have not heard of problems with this in practice.

[5] For example, where it is necessary for the proper performance of the employee's duties that he should reside in the accommodation.

In simple terms, we have been trying to develop ways of identifying what may be thought of as a real 'perk' rather than a 'tool of the trade'. If it is possible to identify perk[6] accommodation directly, it may be possible to do without extensive exemptions: in other words, it may be possible to identify what should be taxed rather than what should not be taxed.

The size of the issue

1.5 In 2011-12 there were around 30,000 individuals recorded as receiving taxable employer provided accommodation. The total value of the benefit was about £130m with a mean of £5,050 and a median of £800.[7] [8] The upper limit of employer provided accommodation was around £63,000 in 2011-12. The majority of employer provided accommodation benefits are between £100 and £5,000. There are also a significant proportion of benefits with a value of under £100, with the majority of these based in the sanitary, domestic and other personal services industry.[9] (We note the HMRC consultation regarding trivial benefits where the proposals may take some of those smaller benefits out of charge although not where they are regular.[10])

Table 1.A: Range of values of employer provided accommodation in 2011-12

Value	Proportion
Under £100	15%
£100 - £1,000	39%
£1,000 - £5,000	26%
£5,000 - £10,000	8%
£10,000 - £20,000	5%
Over £20,000	6%

Source: HMRC

1.6 However, the reported taxable values often do not reflect a market value of the accommodation. In many cases the taxable value of the benefit is much lower than a market based valuation as the amounts are often based on the 1973 gross rateable value of the property. Even so it is the type of benefit in kind with the highest average value at £4,940. Underneath the average lies a large range of values as shown in the table above. The values attributable to employer provided accommodation have not changed significantly between 2006/07 and 2011/12, but bearing in mind the valuation rules and the use of the 1973 gross rateable value for many properties this is not surprising.[11]

1.7 We should acknowledge from the start that some of our proposals may have an Exchequer cost; some, though, will have a Exchequer benefit. Overall, we have as always aimed for simplification and believe that the net cost/benefit of our proposals would be small though the exact result will of course depend on how things are taken forward.

1.8 It is difficult to find figures for the amount of tax-exempt living accommodation provided by employers. As it is exempt it is not reported to HMRC. However, our impression from speaking

[6] In using the term perk, we are conscious that many will argue that any and every provision of accommodation is in the nature of a perk – i.e. it is a benefit. We take that point but in using the 'perk' term as we do, we are doing so in the way that would be understood by the man or woman in the street, i.e. something that really is a benefit well above what is needed for the job being undertaken.

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/324613/Table_4_1_2011-12.pdf

[8] It is worth noting that the tax take will be somewhat less (assuming many recipients would be taxed at 40%, this implies an income tax and NIC take of some £50m or more).

[9] HMRC figures provided to the OTS

[10] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321206/trivial_benefits_exemption_180614.pdf

[11] In 2006/07 the total value was £125 million with a mean average of £4,340

to representative bodies and from some initial estimations made by HMRC is that the number is likely to be significant (see Annex A). Just looking at the HMRC list of classes of employee who get tax free living accommodation it is clear that the numbers could be large. The list includes agricultural workers, ministers of religion, members of HM Forces and managers of public houses living on the premises. The full list is set out below.

Box 1.A: Exemptions

(Note: the exemption tests are explained in detail in a separate section below.)

Exempt under the "necessary" test:

- agricultural workers who live on farms or agricultural estates;
- lock-gate and level-crossing gate keepers;
- caretakers living on the premises. This only covers those with a genuine full time caretaking job who are on call outside normal working hours.[12] It would not cover a shop employee who is allowed to live in the flat above the shop because the employer thinks this will discourage burglaries of the business premises;
- wardens of sheltered housing schemes living on the premises where they are on call outside normal working hours;[12]
- stewards and green keepers living on the premises;

Exempt under the "customary" test:

- police officers and Ministry of Defence police;
- prison governors, officers and chaplains;
- clergymen and ministers of religion unless engaged on purely administrative duties;
- pre-registration house officers before 1 August 2008;
- members of HM Forces and the Diplomatic Service;
- managers of newsagent shops that have paper rounds, but not those that do not;
- managers of public houses living on the premises;
- managers of traditional off-licence shops, that is those with opening hours broadly equivalent to those of a public house, but not those only open from nine until five or similar;
- in boarding schools where staff are provided with accommodation on or near the school premises, the head teacher, other teachers with pastoral or other irregular contractual responsibilities outside normal school hours (for example house masters), the bursar, matron, nurse and doctor; and
- stable staff of racehorse trainers who live on the premises and certain key workers who live close to the stables.

[12] The Working Time Directive has limited the situations where this is accepted. These employees do not automatically fall within the exemption because under the Directive it may not be possible for them to work normal hours and to be on-call outside those hours.

Exemptions (continued)

In addition, veterinary surgeons assisting in veterinary practices and managers of camping and caravan sites living on or adjacent to the site are accepted by HMRC as being persons for whom it is customary to receive accommodation, but who need to show on an individual basis that it is for the better performance of their job.

Exempt under the "grandfathering" principle:

- Any role where the accommodation was provided pre-1977 and was tax exempt then as "representative accommodation" so long as the role (not the employee) has not changed. This exemption is not in the legislation. It was a practical measure introduced when the current living accommodation legislation started from 6 April 1977. The practice is set out in HMRC guidance,[13] which states that employees who were treated as representative occupiers up to 5 April 1977 should be treated as exempt provided circumstances remain unchanged. This also applies to employees who succeed to a particular post regarded as carrying representative status.

Source: http://www.hmrc.gov.uk/manuals/eimanual/EIM11351.htm; http://www.hmrc.gov.uk/manuals/eimanual/EIM11342.htm; http://www.hmrc.gov.uk/manuals/eimanual/EIM11352.htm

The problems

1.9 Some of these were identified in the interim report and have been confirmed in subsequent discussions. Others are new points.

The problems faced by employers in applying these rules have concerned:

- a general failure of the rules to identify when the accommodation is really a benefit
- the application of the exemptions and the inconsistencies and anomalies which arise because of this, and;
- the practical problems in calculating the charge and the inconsistency of treatment between different employees.

A general failure of the rules to identify when the accommodation is really a benefit

1.10 The structure of the rules is to tax all accommodation (save board and lodging provided to those earning less than £8,500) except where living accommodation falls within certain exemptions. Those exemptions are blunt tools for defining who should be taxed on the accommodation. What is clear from our discussions with stakeholders is that the exemptions do not adequately identify when accommodation is a "perk" and hence really what people would regard as a "benefit".

1.11 As we explained in our second report there should be a better and more accurate way of determining what benefits are taxable: a way which accords more with what people would generally expect. Accommodation benefits are yet another example of this. What we would like to be able to do is to identify when the accommodation is really a "perk" as opposed to a

[13] http://www.hmrc.gov.uk/manuals/eimanual/EIM11336.htm

necessity for getting the job done. So for example, accommodation provided for a house master/mistress in a boarding school where that person is needed to be available constantly in place of a parent and is responsible for the pupils' welfare day and night, is essential for them to do the job. An executive provided with a flat in London to be used as and when he/she desires may be justified by the employer as saving hotel costs but it is not essential to do the job. Ideally the tax charge would only apply if the accommodation was in reality a "perk" and not when it is essential to do the job.

1.12 We accept that accommodation is often a valuable benefit but we also hear strongly the point that in many cases employees feel that being required to live in employer provided accommodation is a burden. It is not where they would choose to live but they have to live there to do the job.[14] In some cases, for example where the location is very remote, there is no other accommodation available but in other instances it would be possible for the employee to live away from the job.

1.13 We hear of various situations where the employees simply cannot afford to live locally to do the job unless the employer provides some form of subsidised accommodation. This problem is felt in rural communities where the commuter and second home effects drive up property prices so that farms and estates cannot employ people without providing accommodation. It is also a problem in cities – hence the key worker schemes run in many places where particular occupations can benefit from subsidised housing. In Cambridge the University is currently developing a large area of housing, where land for 1,500 homes will be sold to developers on the open market and an additional 1,500 homes will be constructed by the University to provide subsidised housing for key university staff, such as early stage researchers. Part of the basis on which the planning authority gave permission for the development was that the employees will only pay 30% of their net household income as rent.[15] In that way it is recognised that the development will provide a form of social housing. Yet the tax rules will not tie in with this approach and the tax calculations required for each employee will be extremely complex and time consuming.

1.14 Whether accommodation is a "perk" may depend on the quality and location but it also relates to why the employee is being allowed to use the facilities and whether they can reasonably be said to be receiving a real benefit. Providing a flat in town for the CEO to use when he or she wishes is very different from the employee being put up in the company flat for a few weeks while working on commissioning the nearby plant. But both are in the ambit of the charge, with the employee left to argue for an exception from the charge in the first case and claiming a deduction under the temporary workplace rules in the second.

1.15 We have also heard regularly that working patterns and expectations have changed over the last 45 years. Employees often do not want to live in tied accommodation as this comes with restrictions as to use of property and upkeep requirements. Employees want mobility – i.e. flexibility as to where they will live if they change job or on retirement to be near family elsewhere. Employers do not provide accommodation for life these days. At the same time, many employers and organisations have told us that they have long since stopped providing staff with accommodation unless it can be shown to be absolutely necessary to get the job done.

1.16 Would the size of the accommodation matter? If a person is provided with luxurious accommodation, but that accommodation is genuinely needed to do the job, should the system

[14] This resonates with the approach the courts took pre-1977 when seeking to identify which employer provided accommodation should be taxable. Then a distinction was developed between accommodation which an employee is permitted to occupy as part of their remuneration and cases where the employee is required to occupy with a view to the more efficient performance of their duties. In the latter case living in the accommodation was seen effectively as a burden of doing the job, described at times as consideration given by the employee. See for example, Langley and Others v Appleby (53TC1)

[15] http://www.nwcambridge.co.uk/PA-PDFs/Full/10_Key_Worker_Housing_Statement/10_NWC_Keyworker_Housing_Statement.pdf

tax the luxury? We can see there being concerns about this and there are arguments both for and against taxation in those circumstances. As a practical matter though we hear strongly that businesses in general do not lavish expenditure on employees any more than is necessary.

1.17 We are clear that if the employee has a family and is accordingly provided with accommodation sufficient to accommodate spouse and children, the rule should be that there is no question of apportioning the putative benefit between employee and family, with the latter being a possible benefit even if the former is not. We return to this issue in the valuation section of this chapter at paragraph 1.68.

1.18 While the exemptions try to address what is needed for the better or proper performance of the job, the result of the application of the various rules is that the treatment of employee accommodation is both complex and inconsistent.

Box 1.B: Board and lodging

- Board and lodging rules apply where the employee is provided with meals and somewhere to sleep. If the employee is provided with a self-contained living space with most of the facilities necessary for independent habitation, what is provided then is "living accommodation".
- Employees, other than lower paid employees, i.e. those earning less than the £8,500 limit,[16] are taxed on the cost to the employer of providing the benefit, less any amount made good by the employee.[17] Lower paid employees are tax exempt on the board and lodging where:
  - the employer provides the board and lodging in kind; or
  - the board and lodging is arranged by the employer who settles the bills direct with the provider (not by reimbursing the employee or settling the bill for board and lodging arranged by him/her).
- If the employee is entitled to a gross cash wage out of which he pays for board and lodging, or the employer, with the employee's agreement, deducts an amount to pay for board and lodging, then the gross wage is subject to tax and NICs in the usual way.

HMRC guidance: http://www.hmrc.gov.uk/manuals/eimanual/eim11322.htm

1.19 We have not found any figures about how many people are provided with board and lodging as opposed to living accommodation. However, to take just one sector, the British Hospitality Association has told us that there are 20,000-30,000 employees provided with some form of accommodation in the hospitality sector.

1.20 The exemptions applicable to employer provided living accommodation do not apply at all to board and lodging. (By this we mean board and lodging provided to an employee on an ongoing basis; not board and lodging which is provided as temporary accommodation when an employee works away from their usual location.) We have heard of fewer problems with the rules for board and lodging. They are not in themselves particularly complex – see box above. In

[16] We note and welcome the HMRC consultation on the removal of the lower paid threshold but we have written this report on the basis of the threshold still being in place. See https://www.gov.uk/government/consultations/employee-benefits-and-expenses-abolition-of-the-8500-threshold-for-lower-paid-employment-and-form-p9d

[17] Section 203 ITEPA 2003

many cases (such as hotel rooms not suitable for public use being made available for hotel staff) the cost to the employer is nil and therefore there is no taxable benefit.

1.21 However, because board and lodging cannot benefit from the exemptions provided for living accommodation, an incongruous position results. An employee can be provided with the most basic accommodation, just a bed and basic meals, and be taxed upon it (as summarised in the box above), whereas another employee doing exactly the same job can be given extensive and luxurious accommodation and be able to rely on an exemption. Is the accommodation element of the first really something which should be taxed as a benefit? Bearing in mind the basic idea of taxing a "perk", there are good arguments that much of what is taxed as board and lodging should not be treated as a benefit. It is also not logical in the modern world to tax the accommodation element of basic board and lodging without the ability to use the exemptions used for "living accommodation"; the arguments as to why the accommodation should or should not be exempt should apply to both. Similarly, if an employer pays for hotel accommodation for an employee attending a temporary workplace, this would not be a benefit and would not need to be reported on form P11D (assuming the employer holds a P11D dispensation). However, where employer owned or rented accommodation is provided in the same situation, this would need to be reported on form P11D (the living accommodation box should be used) with relief claimed by the employee from HMRC. The current legislation does not allow living accommodation in employer owned or rented accommodation to be included in a P11D dispensation. The discrepancy in treatment does not reflect whether the accommodation in the hotel or the rented apartment should be taxable in the first place.

1.22 We have therefore considered at length whether a rule could be designed to identify the "perk" accommodation? Could this be combined with a de minimis amount – so that if there is a minimal private benefit the accommodation is ignored?

1.23 We have struggled to find a simple and accurate way of identifying perk accommodation. Accordingly, we accept that the system of charging for accommodation should broadly remain as now, i.e.:

- employer provided accommodation is in principle a benefit
- for the remainder, there should be a range of exemptions from the charge

But that also the most basic accommodation should be taken out of charge entirely.

1.24 With these principles in mind we have considered how taxable accommodation should be defined and how the exemptions from charge could be better drafted to achieve a simpler and more consistent system.

However, first we report on the problems and complexities of the current rules, considering the exemptions first and then the system of valuation.

The exemptions

1.25 A summary of the main employee exemptions[18] to the charge on living accommodation are set out in the box below.

[18] There are also exemptions for accommodation provided to a person because of a domestic or personal relationship rather than an employment one and for accommodation that is provided by a local authority on the same terms that housing is provided to non-employees, but we are not hearing about issues with these.

Box 1.C: Living accommodation

The legislation exempts "living accommodation" (as opposed to board and lodging) provided by an employer:

- if it is necessary for the proper performance of the employee's duties that the employee should reside in that accommodation (and no other)[19]
- if it is provided for the better performance of the duties of the employment and the employment is one of the kinds of employment for which it is customary for the employer to provide accommodation[20]
- if the accommodation is provided as a result of a security threat to the employee where the accommodation is part of the security arrangements[21]

In addition, a form of grandfathering is operated by HMRC outside the legislation. If accommodation was exempt as "representative accommodation" under the pre-1977 rules[22] then, if the job to which the accommodation relates remains unchanged, the accommodation continues to be exempt even if the person employed to do the job has changed.

Exemptions: the necessary test

1.26 We have heard fewer comments about the application of the necessary test than the other "customary" test. That appears to be driven by the fact that it is a narrow test which many people are unable to use. Focus therefore turns to the potentially wider "better performance" test.

1.27 The main point that we have heard is that the necessary test is too narrowly applied. HMRC state "The test is only satisfied where the employee can demonstrate that occupation of the particular property (as opposed to any other property) is essential to the proper performance of the duties of the employment."[23] HMRC relies on statements in a case from 1976: "if it is asserted that it is essential for the servant to occupy the house in order to perform his duties, it seems to me that the servant must establish affirmatively that for the performance of his duties he must live in that house and no other."[24] In addition, HMRC interpret the provisions as requiring that the employee lives in the property provided and no other; the classic example being the lock-keeper who has to live in the lock-keeper's cottage to do their job.

1.28 We query whether it is appropriate to continue to narrow the words of the legislation in this way. The legislation which was introduced after the case does not include the word "essential"; and it is arguable whether the case is authority for the narrowing of the test in this way. The limitation of the rule to one specific property is also something which is debated as being strictly required by the legislation.[25]

1.29 As a general matter our concern is that this exemption and the way it is applied has not kept up with changes to working practices. Time has moved on since the age of servants in the house to perform duties. To take one example, a hotel employee may be able to rely on this

[19] Section 99(1) ITEPA 2003

[20] Section 99(2) ITEPA 2003

[21] Section 100 ITEPA 2003

[22] These were summarised in Langley and Others v Appleby (53TC1) as occurring where it is established: "(a) that it is essential to the performance of the duties of the servant that he should occupy the particular house; or (b) that it is an express term of the employment that the servant shall occupy the premises, and that by doing so he can better perform his duties as a servant to a material degree".

[23] EIM11341

[24] Langley and Others v Appleby (53TC1)

[25] For example, see the statements of Mr Justice Knox in Vertigan v. Brady 60 TC 624, where he found it quite acceptable that the accommodation should not be in a particular house, but alternatively, a house within a closely defined perimeter.

exemption where they stay in the hotel because they are required to deal with the consequences of a fire alarm being activated at night. This appears to be the case even where the employee is only on duty for 5 nights out of 7. However, if the employee shares the duties with others as part of a night shift none of them can rely on the exemption (and they will not be able to rely on the customary/better performance exemption either).

Exemptions: the better performance test and the use of "customary"

1.30 In 1977 there was some discussion of whether "customary" was the appropriate test. The conclusion was that it was: it was less subject to manipulation than looking at whether the employee's contract included a requirement for them to reside in specified accommodation; and it was felt that customs could develop, perhaps needing just a year or two to do so.[26]

1.31 However, we have heard that following the case of Vertigan v Brady,[27] a more restrictive view of the ability of a custom to develop has been adopted by HMRC than the one or two years' concept envisaged in 1977. The court decided that regard needs to be had to the length of time the practice of providing accommodation had existed for and the degree to which it was considered the norm by similar employers. There is no "magic" percentage, although the HMRC Manuals indicate that 50% is the percentage they generally look for. However, in the case itself, the fact accommodation was offered to 2/3 of nurserymen did not mean that it was automatically a custom. The result is uncertainty: how long do new customary practices that reflect changes in roles or employment practices have to exist in order to become accepted?

1.32 Where the job is not on the list of jobs accepted by HMRC to customarily provide employee accommodation, the employer has to demonstrate that there is a custom for employees in similar roles to be provided accommodation. Employers find this onerous. We have heard repeatedly that the list in the HMRC Manuals is applied too narrowly, focussing on the name of the role rather than the job done. For example, a manager of a pub or a campsite may be treated as satisfying the customary test but an assistant manager is not, even though the two may do almost exactly the same tasks and have the same needs to be on-site. Does the fact that someone is called an estate worker rather than a forester mean that their accommodation is not exempt? A school may find that a bursar qualifies for exempt accommodation but the school is faced with problems if the person doing much the same role is called a business manager. A head teacher of a boarding school would be expected to automatically qualify for exemption but a Deputy Head had to be proved even though the jobs were much the same, at least in relation to being on-hand and available for the pupils.

1.33 Questions have also been raised with us over how the HMRC list does not reflect wider requirements. Child protection rules will now generally require two adults to be present to supervise children rather than one. But that does not automatically mean that a second house master/mistress would qualify for exemption. Working time requirements mean that more people will be employed as one person cannot be expected to give '24/7' cover – but as we note under the discussion of the necessary test, using a second person can damage the case for the first. We return to this issue below.

1.34 Meanwhile HMRC have told us that they do consider the substantive duties of the job. There is clearly a lack of understanding of the process HMRC does use. This is possibly driven by the list of jobs which can benefit from exempt accommodation in the HMRC Manuals. The list perpetuates the idea that it is the job title and not the role which is important. We would therefore recommend that as a first step before our more fundamental suggestions are pursued

[26] Inland Revenue advice to ministers, 1977 (notes on clauses)
[27] (60TC624)

that the HMRC Manual guidance is reviewed to make clear that HMRC consider substantive duties and not job titles. We would also encourage consideration being given to the development of a checklist or tool which could help readers assess whether the customary test is met.

1.35 Distinctions in the operation of "customary" have developed which appear arbitrary. For example, all agricultural workers can be provided with exempt accommodation[28] but nurserymen cannot. What is the position of a lettuce grower? We have heard that lettuce growers using intensive greenhouse production do not qualify for exemption despite someone needing to be constantly on hand to tend to humidity and temperature levels. However, when the reason for the accommodation is analysed it is the same in both cases: to be on hand to protect and tend to the produce whether that be chickens or lettuce. Just as agricultural workers will need to regulate the temperature of pig sheds, so a nursery worker will need to regulate the temperature (and humidity) of greenhouses.

1.36 The group which needs to be considered for the application of the customary test is not clear. For example, stable lads of racehorse trainers are on the HMRC customary list. This is a subdivision of all stable lads. What about the treatment of accommodation provided to other stable lads? In the hospitality trade, it is accepted that it is not customary to provide accommodation for chefs. But it would not be acceptable to apply a subdivision to chefs to show that it is customary for breakfast chefs to be provided with accommodation. Why not?

1.37 We have also heard that there is confusion as to whether the test is applied on a national or regional basis. We understand that HMRC view the exemption as requiring the custom to be established on a national basis. But whilst it may be customary to provide accommodation for particular types of jobs in an area, perhaps because of its remoteness, looked at nationally it is not customary.[29]

1.38 There is the question of establishing a custom. We referred at the start of this section to the uncertainty of how long is needed before a custom is established. But even if provision in a sector is eventually accepted as customary, as some bodies have pointed out to us, there is no provision for the new exemption to be backdated.

1.39 What was customary some years ago may no longer be or may cease to be in the future. As mentioned above, employees may prefer to source their own accommodation as it means that they are less tied to the job. Technology or other changes may mean that the custom for the role to be accommodated has fallen away: general farm workers are perhaps an example here.

1.40 In addition, the test looks only at whether the provision of living accommodation is customary. The provision of board and lodging does not count. For example, in a particular kind of employment 25% of employees are provided with living accommodation, 60% are provided with board and lodging and 15% are not provided with any accommodation. Although 85% of employees are provided with accommodation of some kind the customary test would not be met as only 25% are provided with living accommodation.[30] This affects sectors like hospitality where employees such as waiters may be provided with board and lodging in some cases and living accommodation in other cases.

1.41 Customary is only one limb of the "better performance" exemption. We have heard that employers find real problems in applying the better performance part of the exemption. When a hotel is in a remote location, the employer may provide living accommodation to staff but as that accommodation is to enable the staff to avoid travel problems and travel is not part of their

[28] Under the necessary for proper performance test

[29] Again the hospitality industry is an example

[30] From http://www.hmrc.gov.uk/manuals/eimanual/EIM11348.htm

duties, the accommodation cannot be for the better performance of their duties. If employees are provided with accommodation so that they can be on-site as part of a disaster response team, to keep a building secure or to prevent it becoming dilapidated, the accommodation is not considered to be for the better performance of the employee's duties. Although the risk of an incident may be low, the consequences of that risk can be considerable and by being on-site employees are regarded by employers as providing a real service.

1.42 We have also heard of inconsistency in applying the tests. Hotels require a minimum number of staff to be on-site overnight for safety but that number is not consistently agreed by HMRC. Some independent schools feel they receive inconsistent decisions from HMRC as to when a role is exempt.

1.43 HMRC states that in considering whether the accommodation is needed for better performance the employee should be required to be on call outside normal hours; be frequently called out in fact; and in accommodation which provides quick access to the place of employment or other place to which the employee is called.[31] We have heard from numerous representatives that the question should not be how many times the employee is in fact called out but whether they are genuinely needed to be available. Inconsistency of treatment between taxpayers is generated when the focus is on the number of call-outs rather than the need.

1.44 In addition, we have heard that employers feel that the test does not reflect modern working practices and in particular, that an employee may have multiple roles for the same employer. If the accommodation enables the employee to better perform one role what proportion of the whole job does that role need to represent?

1.45 In summary, the customary rule in the current legislation needs to be dropped. It is unworkable in practice and unfair because it favours long established occupations over newer ones.

Exemptions: the 1977 grandfathering

1.46 We are hearing that grandfathering continues and is significant in some sectors (such as education) but we are not in a position to estimate the number of people affected, or the extent to which those grandfathered roles would in fact satisfy one of the other exemptions. However, the continuation of the 1977 grandfathering raises many inconsistencies. The starting point is that it is the role that is grandfathered. Thus provided the role has been kept, successive occupants are 'grandfathered'. This can result in some employees being grandfathered whereas at a similar establishment, changes in the role over the year means that other employees carrying out broadly similar roles are not grandfathered.

1.47 It is also possible for a role to be a grandfathered with one employer, but exactly the same role not to be grandfathered with another employer. This may be because the role for the latter employer did not exist pre-1977. Although HMRC's manuals suggest that the grandfathered roles were expected to be ones which would satisfy the 1977 tests this is not necessarily the case[32] and the non-grandfathered role would then be taxable despite being identical to the grandfathered.

1.48 Examples of grandfathered roles include University Vice Chancellors and Wardens or Heads of House in Oxbridge colleges.[33] HMRC's manuals explain the practice as having arisen because "in practice many who qualified for exemption under the old legislation as representative occupiers would continue to qualify for exemption under the current legislation. So the practical

[31] EIM11350

[32] In particular, the pre-1977 tests did not include a customary test. It was a contractual test instead.

[33] http://www.admin.ox.ac.uk/finance/expenses/guide/12accommodation/

exemption for former representative occupier posts was introduced on the change to the current legislation to stop tax offices making a lot of unnecessary enquiries." There is no statutory basis for the grandfathering and we have not been able to locate any Government or Parliamentary assurance as a basis. As it is simply an HMRC practice taxpayers are exposed to the risk of it being withdrawn at any time following the Wilkinson case on extra statutory concessions.[34]

Exemptions: general inconsistency

1.49 We hear time and again that the exemption rules are too arbitrary as to who can be provided exempt accommodation. It is not just that each rule is seen to give rise to inconsistencies but that overall the result is arbitrary and inconsistent. The Vice Chancellor of a university who only occasionally uses their accommodation can be exempt from tax on the benefit as it is grandfathered, but a low paid sheltered housing warden cannot receive exempt accommodation as they are not on duty out of hours sufficiently. A system which has reached a point of so many inconsistencies is inevitably complex in practice.

1.50 In addition, working practices have changed. Often employees will be doing a mixture of what were previously separate jobs. It is not clear what proportion of their time must be devoted to the role which they perform better or properly as a result of accommodation. For example, a manager of a holiday home site may be doing various on-site jobs but also be the person on-call at night and in some sites may be taking on additional care responsibilities where the site has high numbers of retired occupiers.

1.51 Another example of apparent inconsistency operates in the context of living accommodation provided to racehorse stable lads. The National Federation of Trainers has agreed a set of guidelines for their industry. These include provisions which state that an employee will be exempt from tax on the accommodation providing the employee concerned has responsibility for looking after the horses outside normal working hours and:

(a) the employee lives within the curtilage of the training establishment (regardless of the employee's grade); or

(b) the employee carries out the duties of the kind encompassed in a particular grade (such as being Head lad) and in addition has access to motorised transport and lives within a 5 mile radius of the yard; or can otherwise reach the yard within 10 minutes.

1.52 In the examples given a stable boy sometimes fills up water buckets at night. That in itself is not sufficient to give him exemption from tax on his living accommodation but the fact that the employee lives within the curtilage of the yard and so would be "on call" and would respond to any emergencies and take responsibility for the horses assigned to his care means that he would be exempt. While this may be entirely reasonable it is not consistent with the approach we are being told about in other sectors such as holiday home sites or care homes.

Interaction with other regulations

1.53 We have heard that interaction with other regulations can cause problems for the working of the tax exemptions. For example, wardens and caretakers in sheltered housing are now affected by the National Minimum Wage regulation and the Working Time Directive. As a result an employer may decide that it is not possible for those workers to work normal hours and to be on-call outside those hours. If so, HMRC may not accept that they qualify to receive exempt accommodation under the necessary test.

[34] HMRC ex parte Wilkinson [2005] UKHL 30. We have had comments in meetings that the grandfathering is not in accordance with the principles enunciated in Wilkinson and agree with these concerns. At a minimum the position needs to be clarified as a matter of some urgency.

1.54 In some sectors employees' presence on site is required by regulation. For example, in boarding schools we are told that Child Protection rules mean at least two employees need to be on-site whenever the pupils are there. Thus if the exemption rules permit (say) the housemaster to be in exempt accommodation but not the deputy housemaster, this is in effect in conflict with the requirements of the child protection rules. In holiday camps it will be a requirement of the planning permission that services such as water and electricity are constantly available. This means that employees will be needed to be on-site to deal with problems as and when they arise, day or night. In the pub sector premises must have a 'designated premises supervisor', and if there is a 24 hour licence, the supervisor must be on the premises at all times. It is possible to delegate this role, but whoever is in charge must stay on the premises. No one person is able to be on duty for 24 hours, yet it is only the pub landlord who automatically qualifies for exempt accommodation. Making it clear that HMRC will (and does) look at substantive duties rather than the job title (as recommended above) may help with the problems of jobs being automatically being in or out of the exemptions.

1.55 More generally though we would recommend that if there is a regulatory requirement for an employee to be on-site we would expect the tax rules to reflect this and the employee not to be taxed on the provision of the accommodation. We recognise that there may be questions about proportionality here, in the sense that the requirement to be on-site may only relate to part of the employee's duties. However, we would expect that unless that part was, in effect, a trivial element of the employee's role, we would expect the requirement to be sufficient.

Valuation problems

1.56 The rules for valuing the benefit where the provision is not exempt are complex but for the purposes of this Chapter an overview will suffice to put in context the problems we have heard about.

1.57 The calculation of the tax charge depends upon:

- whether the employer owns or rents the property
- if the employer owns the property:
    - when the property was first made available
    - the rateable value in 1973
    - whether the employee first occupied the property after 30 March 1983
    - whether the employer has held it for more than 6 years
    - whether the property cost plus improvements amounts to more than £75,000
    - the number of employees occupying the property

1.58 If the employer rents the property the rental cost is the amount subject to tax for the employee.

1.59 If the employer owns the property a whole set of provisions apply to calculate the value of the benefit. If the cost of providing the property (including the cost of any alterations and improvements before the year to be assessed) is less than or equal to £75,000 the amount of the benefit is the greater of the annual value for the taxable period of the accommodation provided and the rent paid for the taxable period by the person providing it, less any rent paid for it for the taxable period by the employee.

Annual value is defined in the way set out in the box below.

Box 1.D: Annual value

The annual value is the rent which might reasonably be expected to be obtained on a letting from year to year if:

1 the tenant undertook to pay all taxes, rates and charges usually paid by a tenant, and

2 the landlord undertook to bear the costs of the repairs and insurance and the other expenses (if any) necessary for maintaining the property in a state to command that rent.[35]

If the cost of providing the property exceeds £75,000, there is an additional element calculated on the basis of either a market value basis or cost basis depending upon whether:

- The employee first occupied the property after 30 March 1983;
- The employer[36] had held an interest in the property for the 6 years ending on the date of the employee's first occupation.

1.60 The additional element is calculated by applying the Official rate of interest to the market value or cost basis. This was introduced because in 1983 there was concern that employers were buying employees' properties and granting an option to repurchase so effectively giving their employees interest free loans.[37] £75,000 was chosen as the threshold as that would ensure that the new charge only applied to "very expensive" accommodation. At the time it was stated that the £75,000 threshold can be varied in the future and will be reviewed as circumstances warrant;[38] £75,000 is now equivalent to £220,000 if increased by RPI, or £455,000 if increased by the Nationwide house price index.

1.61 The 6 year ownership rule and use of a market value as the basis for the extra "interest" element was introduced because the cost of the property may not be a realistic valuation if for example, the property was bought 50 years before. It was stated in 1983 that the existing rules did "not effectively tax the true measure of the benefit" because they were based on the outdated 1973 valuations. However, it was recognised that there was a balance between getting the figure right and imposing the cost of frequent revaluations. [39]

1.62 Looking at the definition used in the legislation it would appear that annual value refers to the market rent. However, HMRC use the Gross Rateable Value ("GRV"). The last time properties were valued for GRV purposes was 1973.[40] Properties which do not have a 1973 value – those built after that date or where the records are not available – need to have that value worked out and agreed with the District Valuer. HMRC state that the GRV is taken as the equivalent of annual value for tax purposes because:

- The definition in Section 837 ICTA 1988, which was the predecessor of Section 110 ITEPA 2003, was similar to that used in Section 19(b) General Rate Act 1967 and
- Its use avoids annual revaluations to arrive at current rental value.

[35] Section 110(1) ITEPA 2003

[36] Or other persons providing the accommodation, or persons connected with the employer or other provider

[37] Inland Revenue advice to Ministers, 1983 (Notes on clauses)

[38] ibid

[39] ibid

[40] In Northern Ireland the later 1976 valuation is used. Scotland had a later valuation in 1985. In order that the values are consistent with the English and Northern Irish values the values used are 100/270 x the 1985 gross rating value

- This practice was not withdrawn on the repeal of the General Rate Act 1967 in the interests of continuity of treatment.[41]

1.63 It is notable that when the Tax Law Rewrite project updated the legislation in 2003, the ITEPA provisions did not make any mention of rateable value or the repealed General Rate Act 1967 so it is difficult to see on what basis section 110 can be said to require the use of GRV despite its wording. However, when the rewrite of the rules took place in ITEPA 2003, the Explanatory Notes stated that "this section does not affect the Inland Revenue practice of using the gross rateable value as a proxy for "annual value". That practice will continue." The divergence between what the legislation said and HMRC's practice was perpetuated.

1.64 An HMRC practice therefore developed to ease the administration of the accommodation valuation rules although it is not in accordance with the legislation. We can understand why this administrative easement was introduced, although we query the basis for it. Such non-legislative practices which appear to apply tax rules in ways not contemplated by the legislation, cause us concern. It only adds to complexity if the legislation says one thing and the rules applied are different. As a practical matter the use of GRV causes problems because it is so out-dated. Employers struggle to locate records and in the case of properties without a GRV we are told they simply guess. The GRV basis for properties with a value of less than £75,000 often produces a very small taxable benefit and employers query the efforts required for the small amount involved.

1.65 It is clearly the case that the GRV system is outdated. Even as early as 1983 this was recognised: hence the additional charge for properties with a value over £75,000. As stated above, £75,000 in 1977 is equivalent to £220,000 if increased by RPI, or £455,000 if increased by the Nationwide house price index.

Problems: Inconsistency

1.66 Employees find that the value of the benefit depends upon the way in which the employer holds the property – rented or owned – and if owned on whether the employer had owned it for 6 years before the employee occupied it. None of this is concerned with the real value of the benefit to the employee. As we said before, four employees can be living in four identical properties with significantly different values for their taxable benefit simply because of the way in which the employer holds the property. This is hard to explain to employees or to justify. If an employer changes from owning a property to renting it the employee's taxable benefit will change.

1.67 Although generally it would be expected that an employee will receive a higher taxable benefit where the employer rents the property, this is not always the case and we have been told of instances where the rental value would have produced a lower value than the freehold.

1.68 We have also heard of problems where family accommodation is provided to an employee with a family (noted already at para 1.17). We have been told of situations where HMRC have argued that while the accommodation may be exempt for the employee the element of the accommodation relating to the family is not. We think the approach should simply be that if the employee's position makes their accommodation exempt, that should apply to the full accommodation provided. Accordingly, we think the suggestion that the accommodation can be split is wrong, though we can accept that HMRC would need some protection against abuse in cases where the accommodation provided is patently excessive. (Though the same issue would arise in relation to sole occupancy and in both cases it would presumably cast some

[41] http://www.hmrc.gov.uk/manuals/eimanual/eim11432.htm

doubt on whether the exemption we have suggested for the employee would apply.) One argument against a split route is complexity: how would the apportionment be made? Another is inconsistency: would a married employee have to recalculate the benefit because they have a (or another) child?

Problems: The need for concessions

1.69 An extra statutory concession, ESC A91, prevents a double charge when the full open market rent is used to calculate the annual value, but where the cost of the property plus improvements exceeds £75,000. If ESC A91 applies, there isn't the additional charge that normally arises in these circumstances on the basis that the benefit is already being calculated based upon a "fair" value. Whilst ESC A91 addresses this point, it represents a piecemeal solution.

Problems: Dealing with ancillary services

1.70 The box below summarises the different rules for the tax treatment of services.

Table 1.B:

Services	Exempt accommodation	Taxable accommodation
Council tax, water and sewage	No tax/NICs	P11D/P9D
Other costs e.g. furniture	Capped for tax and NICs* at 10% of net earnings less any employee contribution	Full cost on P11D/P9D*
Heating		

*Unless (i) the employee earns at a rate of less than £8,500 per year and the employer contracts with the supplier and pays the supplier directly in which case there is no tax or NICs due; or (ii) if the employee contracts and the employer pays the supplier Class 1 NICs is payable through payroll.

1.71 We have commented in our previous report about the complexities caused by the system looking at the manner of provision of a benefit; i.e. who contracts and on the issues surrounding the £8,500 threshold.[42]

1.72 However, while we understand that the 10% cap was intended to reflect the fact that a person would have those costs if they occupied their own accommodation, the net benefit type approach is not consistent with the approach to the taxation of employer provided accommodation generally and caused complexity. The tax treatment of ancillary services provided to the lower paid earning below £8,500 is one of the biggest issues we identified in the context of our work recommending the abolition of that threshold. We welcome the publication of the consultation on the removal of the £8,500 distinction but would note again that the removal of the threshold does require the position on these ancillary services to be addressed as well.

1.73 We have also heard of real problems valuing services (e.g. gas and electric) when only part of the building is occupied by staff and there is no separate meter. Apportionment is clearly required but HMRC's approach is inconsistent: sometimes the number of rooms is used; sometimes square footage; sometimes similar properties are used as guides. Some inspectors accept the argument that there is no marginal cost if a flat is in the middle of other accommodation.

[42] https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report

Simplifying the rules for when accommodation is taxable

What is "accommodation" for these purposes?

1.74 We recommend that the most basic accommodation is taken out of the tax charge entirely, noting that this may result in an Exchequer cost. HMRC currently state that "the HMRC view is that living accommodation is something that gives the occupant the necessary facilities to live domestic life independently without reliance on others to supply basic needs. In practice we would be looking for an individual to at least have the use of a refrigerator and full cooking facilities, even if such facilities are shared." We would recommend that anything less than this should not be taxable as a benefit and accordingly this principle should be put into legislation. We accept that this seems to introduce another definition and boundary into the legislation and thus add to complexity; but we feel that our recommendation is about making clear an existing practice and simplification will follow because (a) the practice becomes better known (b) the definition is clearly set out.[43]

1.75 We have considered whether this approach should be extended to situations where an employee is required to live in employer provided accommodation but still maintains their own residence. This has been an approach used in Australia, although not without some difficulty. Although we can see the argument that where the employee still has a genuine connection with the main residence and needs to maintain it, such accommodation would not be a real "benefit" to the employee, we have concluded that identifying the net benefit in such a case would be complex.

The simplest options

1.76 As regards "living accommodation" as opposed to the basic board and lodging, some people do argue that even when the accommodation provided is essential to do the job, the fact that the employee is provided with somewhere to live is a benefit with potentially significant value. The employee does not need to incur housing or travel costs, the costs which we expect most people consider to be major items of expenditure. In addition, many low paid employees receive accommodation which is implicitly offset against the low value of their other remuneration. If such workers were to have to pay for accommodation themselves they would need to be paid higher wages.

1.77 The simplest rule would reflect the value in accommodation and would tax all accommodation as a benefit at the open market rental value: one simple and easily expressed rule, with no exemptions. The market value would take into account matters such as remoteness of the accommodation. It could also potentially take into account the peculiarities of the accommodation, such as the fact that a house master's/mistress' accommodation is set within a building occupied by pupils.

1.78 New Zealand has adopted this approach. All accommodation is to be taxed as a benefit calculated on the basis of open market value, although the amount brought into charge is reduced for Ministers of religion and members of the armed forces.

1.79 However, this tax-all approach makes no attempt at trying to identify when the accommodation is a "perk". It would not recognise the situations where the employee has to reside in accommodation. In addition, it would undoubtedly give rise to a significant tax charge for many people who currently receive tax free accommodation and a change to this wider rule

[43] An alternative would be treat basic accommodation in the same way as general provision of accommodation away from the normal place of work under the travel & subsistence rules. If the travel & subsistence rules don't apply, perhaps because the accommodation is too near the normal place of work, then the normal accommodation benefit rules would apply.

would bring significant disruption to some important business sectors. At a minimum there would have to be lengthy transitional provisions.

1.80 Therefore although such an approach is attractive on purely simplification grounds, we do not recommend it.

1.81 The mirror image of this approach would be to exempt all employer provided accommodation where it can be shown that the accommodation is reasonably required to perform the employee's duties. We have heard very clearly from employers that accommodation is an expensive thing for them to provide and they only do so where there is a real need to enable the employee to do their job properly. A general exemption has some attraction, but we realise that it would have to be subject to anti-avoidance measures, especially for owner managed businesses. In addition, we recognise that there would be considerable pressure to focus the exemption to a relatively narrow set of circumstances: it would be seen as being too tempting for employers to argue that the accommodation was really needed when the provision was tax free. We have therefore not recommended pursuing this option as we feel that at the end of the day the result will be a set of complex new rules, and a probable Exchequer cost. But we would be interested in views over whether this sort of approach could be made to be workable in a simple manner.

Our recommendations

1.82 We think the right approach is to work to improve the current framework and its main stages, i.e.:

- What is accommodation (see above)
- What exemptions apply
- How the benefit is calculated

1.83 The main problems we are hearing about concern the inconsistencies and interaction between the various exemptions and the application of the customary test in particular. One possibility would be to remove the "customary" part of the better performance test. If the accommodation is necessary for the proper performance of the job or is for the better performance of the job, the accommodation would then be tax exempt. This would have a potential Exchequer cost as it would make the exemption more widely applicable. However, at the same time the 1977 grandfathering could be stopped so that the grandfathered roles and accompanying accommodation would need to be assessed under the legislative exemptions. Some of those would fail to be exempt. We are not in a position to estimate the values of the "winners and losers" under such an approach.

1.84 An alternative, and one which we prefer, is to reformulate the exemptions as a whole with the aim of focussing more accurately on what accommodation is really a "perk". Such a formulation would focus on why some accommodation should be tax exempt. However, there are clearly policy issues which are involved here. Our aim is to find a simpler way of taxing accommodation benefits, which can be more easily operated by HMRC and more easily understood and applied by employers and employees. The current system is neither simple to operate nor consistent in identifying what should and what should not be taxed. Whatever change is made though there will be potential winners and losers and policy decisions will be needed, ideally in the context of the sort of wider issues we have noted in this chapter. Those

decisions may mean that the changes should exempt more or less accommodation, but that is a matter for government.[44]

1.85 The key elements which are coming out of the work we have done, and the basis for employers arguing that the accommodation they give is not in essence a perk, but needed to get the job done, are:

- the employer requires the employee to live in the accommodation to perform their duties and this is encapsulated in the contract of employment;
- the reason the employer requires the employee to live in the accommodation is that it is necessary to enable the employee to protect[45] buildings, people [46]or assets[47]; or
- the reason the employer requires the employee to live in the accommodation is because the job requires a very early start in the morning or a very late finish at night; or
- the reason the employer requires the employee to live in the accommodation is a result of regulatory requirements.

1.86 We would hope that it is possible to formulate an exemption which would encapsulate these elements. The existing exemptions and the 1977 grandfathering would be replaced. This would result in simpler and fairer rules. Some aspects would be revenue raising; some would lead to Exchequer costs.

1.87 However, we do raise particular categories of employer whom it may be thought appropriate to deal with separately. As in New Zealand, it may be thought appropriate as a matter of policy to modify the rules in their application to specific groups such as Ministers of religion and the armed forces.

1.88 We are aware that charities often have strong reasons for housing employees in charity owned accommodation. It may be that the property is occupied by the employee for security reasons or to prevent the property becoming dilapidated. In such a case we would expect the formulation set out above to apply and exempt the accommodation benefit. However, in other cases it is routine for employees to be provided with tax exempt accommodation and changing that treatment will be a major policy change. These cases include accommodation provided by educational charities, whether school or higher education and accommodation provided to Ministers of religion.

1.89 We note that in Australia there is an exemption for certain not-for-profit organisations satisfying specific requirements.[48] The point has been put to us forcefully by a range of charities that they have a legal obligation to use their assets and funds for charitable purposes only. Thus any provision of accommodation for an employee must be demonstrably in the furtherance of the charity's objectives. There is a considerable degree of logic in resting a tax exemption on this rule, instead of trying to devise further tests, bearing in mind that various changes have been made to the tax rules around charities to guard against abuse. An alternative would be to cap the amount chargeable for such charity-provided accommodation or to charge only a

[44] There is a potential for Exchequer cost or benefit depending on whether more or less accommodation is exempt.

[45] 'protect' would mean both from a security point of view but also fire risks and general safety – so therefore would cover the residential site employee who has to live on site to ensure water and electricity supplies are not interrupted.

[46] 'people' could include the employee – so covering a situation where the employee has to live in the accommodation for security reasons.

[47] 'assets' here must be read as including both fixed and current assets – so therefore includes growing crops, for example.

[48] See the overseas summary attached at Annex D.

proportion of the value. However, that seems to risk bringing in another layer of complexity and we would prefer to have a simple general rule.

1.90 Set against this is the problem that a charities exemption would be a very blunt instrument. The same accommodation provided to two employees doing the same jobs would be taxed differently purely as a result of whether the employer is a charity.

1.91 We think it is preferable to develop a fair rule that covers all potential employees. But this is something that can be explored in consultation on our proposed main rule, to test whether there is significant disadvantage to certain categories of employees or sectors.

Transitional rules

1.92 Clearly our recommendation could have a significant impact for some taxpayers who currently receive tax exempt accommodation and who would not under a reformulation. We would envisage transitional rules being necessary. Those transitional rules could be expressed in such a way that the new rules only apply to accommodation when a new employee is provided with the accommodation; or there could be a fixed number of years before the new rules apply. The latter would avoid the situation of two sets of rules running side by side for possibly many years and would be simpler, but we recognise that the former may be considered a less dramatic way to deal with a major change for those concerned. We would not recommend that the current 'grandfathering' exemption is emulated: any transition should be for the current incumbent, not their successors.

Alternatives

1.93 We have considered other possibilities which could offer some simplicity gains but less than our recommendation:

- Improving the 'necessary for proper performance' and 'better performance/customary' tests and their application. We would envisage removing the use of the 'essential' concept which is not in the legislation and making it possible to use the necessary exemption even where there is more than one property that could be occupied by the employee to do the job.
- We would also recommend updating the customary test, perhaps replacing it with "current practice in the industry". Such a concept should have clear guidelines about how it is operated including setting out a percentage of the industry which should have accommodation provided. HMRC should clear that the focus is not on the job title but on the nature of the job being undertaken;
- It should be made clear that the customary test, as reformulated, can apply regionally rather than having to apply nationally, if necessary by legislative amendment;
- Keeping the new tests up to date, probably by committing to a review of their operation every five years with relevant industries to ensure that current practices are properly reflected and that there is consistency of approach from industry to industry;
- Providing a cut-off date for the 1977 grandfathering.

Simplifying the rules for what value is taxed

1.94 The simplest approach would be to tax all accommodation on the basis of open market rental value. This would apply whether the property was owned or rented by the employer[49]; in the latter case the rent paid would no doubt in most cases be open market value.

1.95 From the initial discussions we have had with stakeholders and the Valuation Office Agency (VOA) about this as a possibility, it would appear that in most cases this would be an easily identifiable value. We would expect it to take into account the facts peculiar to each property such as lack of privacy (e.g. for accommodation in a historic property) and the remoteness of the property.

1.96 Opinion has been split as to how easy it would be to find a market rental value for properties where there are real restrictions involved. Those include:

- the only person who can occupy it is an employee of that employer; for example the rooms in a boarding school's boarding house occupied by the house master or mistress or security considerations restricting who can occupy the property.
- the accommodation is part of a much larger property such as a historic house.

1.97 We recognise that further work is needed to clarify just how a market value rule would work in such circumstances. We have had strong views expressed that market values can be developed easily enough for these purposes. We think that the market value would reflect those limitations. If so, the market rental value would be commensurately low. For 'ordinary' properties, a market value rental is readily ascertainable – these days often at the click of a mouse.

1.98 Clearly revaluing properties every year would be a burden for employers. We would envisage that either an index is applied to the value for say 5 years or (preferably) the valuation is only required every, say, 5 years. We note that in Australia the market value is indexed for up to 9 consecutive years. In most cases obtaining a market rental value should be straightforward and we would not expect HMRC to impose significant evidential hurdles.

1.99 We recognise that market rental value would be a significant increase in taxable benefit for some taxpayers though we are unclear how many people would be affected in this way. It would be important to ascertain during consultation who would be affected – and by how much.

1.100 It may then be appropriate to provide transitional relief, perhaps by spreading the increase over a set number of years. Alternatively, it may be thought appropriate to lessen the impact for certain groups of taxpayers. One way to do this would be by applying discounts for certain occupations. Another route to lessen the impact for certain groups such as low paid employees could be a cap on the value of the accommodation benefit expressed as a percentage of remuneration where the remuneration was less than a specified amount. However, all these possibilities bring additional complexities and the risk of further 'rough edges'. Our recommendation is to explore the need for transitional protection as part of the consultations: only when the scale of the issue is properly ascertained will it be possible to devise a fair solution.

Alternatives

1.101 We have considered other ways of valuing the taxable benefit. None of them has as great a potential for simplification as the market rental value but they could offer simplification gains as compared to the current position. The other possibilities we raise here are:

[49] Where a property is owned or rented by one group company and used by an employee of another member of the group, we assume that there would be a 'look through' to the first company's position.

- Applying some form of scale rate system; for example by having a table setting out the values to be used based on one or more of the square metres of accommodation, number of rooms and other facilities. This would need to include provision for regional variation in values. It has some attractions as it could provide a way to get around the problems (if any) of valuing unusual properties, properties with restrictions on occupiers and properties which are integral to other buildings. However, the scales would require frequent updating by HMRC.
- Using house insurance rebuild costs as the basis to calculate the value. This has the advantage of not increasing administrative costs for the employer as they would assess this on an annual basis for buildings insurance purposes. There are also online calculators or lists such as the RICS list which can assist. Some employers have argued for this as a way to remove various external factors that may impact on rental or market purchase prices, outside an employer's or employee's control, such as demand in rural areas from non locals who will commute to higher paid jobs outside the area, or from those who can afford a second home. However, there would be winners and losers under such an approach. When considering the insurance rebuild costs should that include the particular stylistic features of the property or should it be on the basis of a modern equivalent? Depending on the property concerned one or the other may give a lower value.
- These possibilities could be applied to both properties rented by employers and those owned by employers; or could be applied just to the owned properties. We see arguments for either: applying the same rule to both would be simpler but it could produce odd results for rental properties when in fact the employer is paying a market rental value.

Conclusions on valuation

1.102 We have pointed the way to a simpler and potentially fairer valuation basis. But if these recommendations are not pursued we would recommend that at a minimum the existing valuation rules are simplified and the basis of charge put on a clear statutory footing. In other words, if GRV is still to be used the legislation should say so.

1.103 We cannot find any reason to continue with the different valuation for properties under or over £75,000. The original rationale of taxing high value properties differently has long since gone. One valuation rule would be a real simplification step.

Ancillary services

1.104 We would recommend a general rule that benefit of the provision of ancillary services other than council tax, water and sewage is tax exempt if the benefit of the accommodation is tax exempt.

Other points

1.105 We have noted a number of recommendations that would reduce administration, reporting and processing for employers and HMRC. Many are capable of being introduced by HMRC through administrative changes rather than requiring legislation. We have been told about some ambiguity about whether a tax charge arises for the times when a property is actually used or for the times when it is available for use. We would recommend that the position is clarified. We would encourage HMRC to provide examples or make clearer the guidance to illustrate the difference between when the charge will be for actual use and when it

will be for the whole year regardless of actual use. However, we also consider that the frequency of use of accommodation is a factor in deciding whether it is really a benefit.

1.106 A linked general point is where accommodation is in multiple occupation and there is a need to apportion the benefit. We have been told of strange results, for example:

- One occupant moves out – so the benefit for the other(s) is increased through no fault of their own, usually without any increase in the real accommodation they use
- It has also been suggested that apportionment can result in a charge greater than if one person was occupying the property, perhaps where there are changes in occupation during the year. However section 108 ITEPA 2003 should limit the cash equivalent of the benefit to the cash equivalent that would have arisen if the property had been provided to a single person.[50]

1.107 We think that in the first of these situations, there should be no increase in the benefit charged if the occupant does not get a greater benefit. The second should be covered by confirmation that the total benefit cannot be greater than the charge that would apply to a single occupant.

1.108 There is the concept of temporary accommodation which we have reported on before[51] and the problems noted above with staying in employer owned accommodation. As before, we recommend that where a deduction is available for attendance at a temporary workplace, living accommodation should be included in a P11D dispensation whether provided through hotel accommodation or use of a company flat (or equivalent). This would require a change to primary legislation.

1.109 We can also see no reason why the tax on an accommodation benefit cannot be settled through a PAYE settlement agreement. We can understand HMRC feeling that a regular accommodation charge should be made on the employee; but if the employer believes that there is no real benefit to the employee, surely they should be able to settle the tax due? If there are situations that HMRC are concerned about, these should be provided for rather than a blanket prohibition.

[50] See HMRC EIM11410

[51] See second report at https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report

2 Termination payments

Overview

2.1 From our work looking at termination payments over the past year it is clear that it is an area in which confusion and uncertainty are frequent:

- Confusion – because many employees believe that the first £30,000 of any 'payoff' will be tax-free, and are surprised and upset when they find that is not the case
- Uncertainty – because many employers are unclear exactly how the exemption operates.

2.2 In the vast majority of cases, employers are not trying to get out of paying tax: they simply want to pay the correct tax and therefore avoid incurring any penalties that might otherwise arise. The complexities in the current system are getting in the way of them being able to achieve this. They have told us that, above all, they would like to see a regime that is clear and easy to administer. As for the employees, who are after all losing their jobs, the thing they most want is certainty about the value of whatever they are receiving. Receiving a later tax bill or, as is more often the case, having the employer deduct too much tax because it is unsure of the correct tax treatment, is particularly unwelcome as the employee will probably be using the termination payment to subsist on; many clearly feel that not taxing a payoff is a matter of fairness (though this may be qualified in the case of large payments).

2.3 There is clearly a need to improve the current situation: our proposals are aimed at achieving this and developing a simpler system. The problem we have is that the work we have done has not pointed the way to an obvious single answer as to how the system should be changed. Consequently, although we have a preference for one particular route, the proposals that we have put forward in this chapter are of a more exploratory nature than in some of our reports. We think we have made the case for reform; if Ministers accept that part of our report, we think that the first decision will have to be to confirm the overall policy to be applied.

2.4 Overall, we believe that, subject to certain exemptions, all payments made in connection with a termination of employment should be subject to income tax. In this chapter we propose that, alongside this, there should be:

- a new income tax relief available in circumstances where the employee qualifies for a statutory redundancy payment, instead of the current £30,000 exemption under section 403 ITEPA 2003; and
- a government review of the existing exemptions, reliefs and reductions which apply to the existing charge under section 401, in order to establish in each case whether they should be retained as part of the wider reform of income tax treatment of termination payments.

2.5 These proposals should first be the subject of a formal consultation process in order to establish in more detail how individual taxpayers, businesses and HMRC would be impacted by the reforms if they were introduced. This consultation should also include a review of whether

there should also be a reform to the NICs treatment of termination payments, in order to align the two regimes in this area.

2.6 As they would involve fundamental change to the present system, it is clear that any of these proposals, if implemented, would not be introduced in the immediate future. Therefore, we have also proposed some interim measures to deal with key concerns that have been raised in relation to the current regime. We consider that these should be implemented as soon as possible, pending the more radical reform that we believe is needed.

Key complexities under the current regime

2.7 Our Interim Report[1] highlighted problem areas which employers, advisers, employee representative bodies and HMRC have identified to us in relation to the current system. In summary, their main concerns have been:

- The regime is widely misunderstood. There is a general public perception that any payoff of up to £30,000 would automatically benefit from tax relief, regardless of the basis and circumstances of the payment.
- The interaction of the income tax legislation on termination payments with the tax on general earnings (as well as certain other complexities of the regime), which mean that it is necessary to establish the true nature of each separate element of a termination payment in order to be able to work out its tax treatment. This is often difficult and time-consuming (for both employers and HMRC).
- This interaction has developed through HMRC practice and (to a lesser extent) case law over issues such as contractual payment in lieu of notice (PILON) arrangements, non-contractual PILONs (auto-PILONs), and payments around retirement age; At the same time the nature of termination payments has changed with more awards for breaches of rights. What was once a simple rule that was effectively clear has become complex and opaque.
- The regime is unfair: entitlement to the termination payment under the employment contract is a determining factor as regards how the payment should be taxed. As a result of this, the well-advised can often end up better off than the unadvised, as they are more able to structure their employment contract (or, indeed, their termination payment) to achieve the better tax treatment.
- Many employers report that they can obtain guidance from HMRC; others say this is difficult to obtain and they have to turn to (paid) advisers. Whatever the route to a solution, it is clearly taking time and money.
- It is illogical that the income tax treatment and the NICs treatment of termination payments which qualify for the £30,000 income tax exemption should operate so differently.[2]

2.8 Although the current digitisation program for HMRC may reduce some of the administrative aspects of termination payments, we consider that this will not have a significant impact on the issues outlined above. The system is fundamentally in need of reform.

2.9 For further details on how the current regime operates see chapter 7 (p57) of our interim report.[3]

[1] https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-interim-report

[2] Although it worth noting that the absence of a NICs charge is generally beneficial to both employer and employee

Proposals for reform of the income tax regime

Overall approach

2.10 The simplest approach is to tax all payments made on the termination of an employment, whatever their basis. Some employers have told us that they would prefer this approach, on the basis that this would result in a system that is easier to understand and much more straightforward to administer.

2.11 We have spent some time looking back at the 1955 Royal Commission on the Taxation of Profits and Income that considered the question of taxing termination payments in the 1950s. Imposing tax on all termination payments appears to have been the preferred approach when the income tax regime which is specific to termination payments was originally introduced in the Finance Act 1960. The prime intention behind that legislation was to tax extravagant pay-offs, but also to capture payments of whatever size – as much as anything because it is very difficult to separate excessive payments from the reasonable ones.

2.12 However, a flat value income tax exemption was introduced alongside this general charge on the basis that this would exempt from tax the sort of redundancy payments made to manual workers and clerical staff at that time. In 1960 this exemption was set at £5,000, but this has been periodically revised to the present £30,000 (which has remained unchanged since 1988).

2.13 These original considerations remain relevant today. From a pure simplification basis, imposing tax in full on all termination payments is the simplest approach. However, it is likely to have a significant cost impact for some people, particularly those lower paid employees who may more often be the ones receiving smaller termination payments[4]; who are, after all, losing their job. There is clearly a policy decision to be made here on how payments should be taxed/exempted: such policy matters are in strictness outside the remit of the OTS. Our inclination, though, is that the policy which underpins the current structure is correct.

2.14 We therefore consider that, subject to certain exemptions, all payments made in connection with a termination of employment would be subject to income tax. However, we propose that a new income tax relief should be available instead of the current £30,000 exemption under section 403 ITEPA 2003. This relief should only be available in cases of statutory redundancy and would apply to at least some amounts currently taxed as earnings as well as payments caught by section 401. Statutory redundancy is a well-understood concept and should be simpler to apply in practice than the current rules.

Income tax relief / exemption

Problems with the existing exemption

2.15 As highlighted in our Interim Report, there are various problems with the way in which the current £30,000 exemption operates. The main criticisms that we have received are that:

- There seems little point in having the exemption as the tax provisions on general earnings take precedence over those for taxing termination payments (depending upon why the particular payment has been made). Therefore, in practice, we suspect that most termination payments will in fact be taxed in full as general earnings instead of being able to benefit from the £30,000 exemption;

[3] https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-interim-report

[4] In that the higher paid who might receive a payoff well above £30,000 are already taxed on the value above £30,000 and thus would see a proportionately smaller change to the net value of their payoff.

- The circumstances in which the £30,000 exemption may apply are unclear and involve a detailed examination of the different elements of the termination payment and the circumstances in which it was paid. This all leads to HMRC arguments around issues such as PILONs, auto-PILONs, and payments around retirement age[5];
- The rules surrounding the exemption are sometimes difficult to apply. For example, in relation to the manner in which the threshold operates where there is successive employment by two associated employers; and
- Some of the rules surrounding the exemption are felt to be redundant, most particularly in relation to payments made on a change in the duties of or earnings from a person's employment[6].

2.16 We have explored various alternatives for structuring an income tax exemption, looking at both (a) the circumstances the exemption should be available and (b) the value level of the exemption. Whilst our general objective is simplification, we have to have regard to the impact of our proposals on the Exchequer; these two factors have some bearing on each other.

Approaches for revising the existing exemption

2.17 Possibilities that we have considered and discarded include simply increasing the existing £30,000 threshold in line with RPI (so that it would now be almost £71,000) or linking it to the employee's length of service with the employer. An increase in the level of the £30,000 exemption would offer a measure of simplification in that a few more termination payments would be exempt from income tax. However, although it would be a simple change in itself, it would not result in any simplification to the regime as the difficulties arise from whether the exemption applies rather than the amount of the exemption. Similar arguments mitigate against the idea of tying the level of exemption to the length of service in some way, with the additional burden of record keeping for the length of service.

2.18 It has also been suggested to us that the £30,000 exemption (or a higher exempt amount) could be linked to an individual throughout the whole of his working life, so that if someone leaves employment with one company, they can use some (or all) of the exemption, and carry any remaining amount over to their next employment. If there is no gap in employment history, they would simply retain the remaining exemption amount until retirement. A further possibility would be to combine the exemption with the tax free lump sum on pensions. We understand that the NICs system already provides a mechanism through which it would be possible to carry out the necessary tracking of the exemption amount each individual has left at any point in his career. However, we have discarded these ideas as they will not simplify the regime as a whole (and could potentially add to the administrative burden for employers).

2.19 Accordingly we have not pursued these options further, but simply note them as possible routes that we do not recommend given our objective of simplification.

2.20 We believe that more radical change is needed in order to reduce the current complexities surrounding the exemption.

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[5] We have been told many times by employers that any payment to someone leaving who is approaching 60 – the 'normal' retirement age – can be challenged as an unapproved retirement benefit scheme rather than qualifying as a termination payment. With the demise of the idea of a normal retirement age, it is an interesting question as to how valid such lines of argument will be in future.

[6] The wording of section 401 ITEPA 2003 currently extends to these types of payments, so that they are also potentially able to benefit from the £30,000 exemption. However, this wording is effectively obsolete, as the tax provisions on general earnings take precedence over section 401, so that in practice any such payment would ordinarily be taxed as general earnings instead. We feel that it is simpler and more sensible for such payments to automatically be taxed as general earnings. Therefore, the exemptions that we have proposed should not be available to payments made on a change in the duties of or earnings from a person's employment.

Alternatives that would achieve more radical change

2.21 When exploring the right approach for radical change, we have considered two alternative strategies which are aimed at achieving this in very different ways. These are:

- A "blanket" exempt amount that applies more universally; and
- An exempt amount that applies only in cases of statutory redundancy.

Each of these is considered in more detail below.

2.22 Our preference is for the second of these approaches, which is linked to statutory redundancy, as we believe that this will achieve more obvious simplification and give considerable extra certainty. However, for the reasons outlined below, there is no obvious right answer, and we consider that a formal consultation is essential in order to fully establish the potential impact of the proposal on both individual taxpayers and businesses, as well as HMRC and the Exchequer, and to refine the terms on which it would operate. Any such consultation could also explore the feasibility of our alternative "blanket" exemption – which in many respects may be fairer and more popular.

Income tax exempt amount: The blanket approach

Possible structure of a blanket exemption

2.23 Under this approach, the income tax exemption would extend more generally so that it could potentially be applied against any payment made in relation to a termination of employment. All potentially taxable termination payments received by the relevant individual (including contractual ones) would be aggregated together and then the income tax exemption would be applied against these, so that the individual would only be subject to income tax on their termination payments to the extent that the aggregate value exceeded the threshold value of the exemption. The exemption would therefore potentially be able to apply to any termination payment, regardless of:

- The nature of the payment. For example, it could be applied as relief against a payment for a restrictive covenant[7] or a payment under an employer financed retirement benefits scheme[8], which are unable to benefit from the £30,000 exemption under the current regime[9];
- Whether or not there was a fixed entitlement to the payment under the terms of the employment contract.

2.24 This exemption would need to be structured to include anti-avoidance provisions, for example to require that:

- the exemption is only available on the loss of a job
- there must be no employment with the organisation or connected parties for a specified period after termination; and
- the payment is not a reward for work already done or a substitute for salary in final months.

[7] Currently taxable under s 225 to 226 of ITEPA 2003

[8] Currently taxable under ss 393 to 400 of ITEPA 2003

[9] Although we acknowledge that in order to achieve this, there would need to be amendments to the primary legislation on these two types of payments, which arguably could add some complexity.

2.25 The value level of the exemption would also need detailed consideration. Assuming the aim would be cost neutrality in the context of this proposal, one practical approach would be for the value of the blanket exemption to be lower than the current £30,000 exemption. This has some validity in the current age of austerity, where average pay-offs in the UK are now near £14,000[10] and therefore significantly below the current £30,000 threshold.[11]

Rationale and benefits of a blanket exemption

2.26 If the income tax exemption was to be applied more widely to termination payments in general, this should remove the current need for employers (and HMRC) to separate out and identify each element and decide whether or not it is taxed under general earnings or another taxing provision or otherwise falls within section 401 ITEPA and is therefore able to benefit from the exemption. However, we understand from HMRC that in some cases it may still be necessary to examine the reason for the payment being made, in order to stop avoidance.

2.27 Ensuring that the exemption is available regardless of the terms of the employment contract should also reduce the unfairness that exists in the current system: the well advised will no longer be in a potentially stronger position as the wording of the employment contract (and indeed the termination agreement) will no longer be relevant to the availability of an exemption.

Problems with a blanket exemption

2.28 This blanket approach would offer considerable simplification, but it would still be necessary to establish whether a payment is connected to the termination (which, in itself has resulted in some uncertainty in the past, for example in relation to ex-gratia gifts[12] and discrimination payments[13]).

2.29 The idea of a simple exemption raises three significant issues:

- the need for anti-avoidance measures
- the cost impact for both the Exchequer and businesses
- certain individuals will receive less favourable tax treatment

2.30 We consider each of these further below.

Anti-avoidance in relation to a blanket exemption

2.31 We acknowledge from the outset that the idea of a simple exemption will raise immediate concerns around abuse. In simple terms, could an employer and employee gain advantage by the employee being fired each month and then rehired, probably by an associated company of the firer?

2.32 HMRC would clearly need to protect the Exchequer against such obvious abuse possibilities. We have sketched out some provisions above but we are concerned that the provisions deemed necessary would serve to severely restrict the availability of the relief. In turn, any restrictive provision would no doubt require various definitions and interpretations, with the risk that the resulting rules would be as complex and uncertain as the current position. However, a simple purposive clause may suffice.

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[10] HMRC figures supplied to the OTS

[11] It is worth nothing at this juncture that a reduction in the threshold could be publically perceived as a purely tax raising measure rather than a simplification measure.

[12] Resolute Management Services Ltd v HMRC [2008] UKSPC SPC00710

[13] See Oti-Obihara v HMRC [2010] UKFTT 568 (TC) and Walker v Adams [2003] STC 269

Exchequer cost of widening the circumstances in which the exemption will apply

2.33 Depending upon the level of the value exemption which is to apply in these circumstances, a blanket exemption could be costly to the Exchequer, as it would allow for some tax relief on all payments made on termination. While we believe the majority of which are at present fully taxable[14] as they are treated as earnings by virtue of an existing right under the employment contract. This is extremely hard to quantify in terms of costs impact.

2.34 A way of reducing Exchequer cost would be to introduce NICs on termination payments to the extent that they fall above the relevant value threshold (see our discussion in section 3 below). However, we appreciate that this would lead to additional employer NICs costs. Therefore, in cases where the employer has not already agreed the level of the payment, this could lead to a reduced payment for the individual employee, on the basis that an employer is unlikely to increase its redundancy budget.

Costs impact for employees and employers if the tax exempt threshold is reduced:

2.35 Assuming that any blanket exemption could only be implemented with a lower value exemption than the current, £30,000, certain individuals and businesses would lose out if this was introduced. These include:

- Departing employees receiving termination payments that qualify for the current £30,000 exemption but are higher than the limit for the new exemption. At present, such payments would be paid tax-free to the extent that they were less than £30,000, whereas under the new regime they would be subject to income tax to the extent that they exceeded the new value limit;
- Employers who make termination payments which are higher than the limit for the new exemption, but within the current £30,000 exemption, and who tend to gross up such payments so that the employee does not bear the tax cost. Such employers will be faced with greater financial costs if they continue to gross up these payments.

2.36 The administrative aspects (for employers and HMRC) would also be relevant. If the limit was to be reduced below the current £30,000 exemption, a larger number of termination payments would exceed it. This would potentially result in a greater administrative burden generally in dealing with the tax treatment of these payments, rather than simply taxing them as general earnings. Against this, simpler rules would undoubtedly save all concerned considerable time.

Conclusions on introducing a blanket exemption

2.37 Whilst the "blanket" approach to the exemption may well offer simplification, the value threshold of such an exemption may need to be set so low as to significantly reduce its benefits, otherwise it is likely to come at too high a cost to the Exchequer. Employers may also take the view that a widening of the exemption makes the regime more difficult to administer. We have therefore looked at linking the exemption to statutory redundancy instead, which would result in a significant narrowing of the circumstances in which relief would be available but would give a simpler boundary between what gets tax relief and what doesn't. We have set out below how we think this proposed exemption should work in practice.

[14] Under section 62 ITEPA 2003. Alternatively, the payment may be taxed under section 225 and 226 ITEPA 2003 (if it is a payment for a restrictive covenant) or other charging provisions which, in accordance with Section 401(3) ITEPA 2003, take precedence over section 401.

Income tax exempt amount: The statutory redundancy approach

Structure of the statutory redundancy exemption

2.38 Under this proposal, the income tax exemption would apply in narrower circumstances than the current regime, so that:

- the exemption is only available in respect of termination payments made to individuals who qualify for a statutory redundancy payment in accordance with Part XI of the Employment Rights Act 1996 or the Employment Rights (Northern Ireland) Order 1996, and;
- the value of the income tax exemption in these circumstances is a multiple of the statutory redundancy pay that the particular individual receives.

2.39 All payments linked to the termination received by the relevant individual (including his statutory redundancy payment, which is already tax-free[15]) would be aggregated together and then the income tax exemption would be applied against the value of these, to provide tax relief up to the value of the exemption. Subject to this value limit, this relief could therefore extend to any termination payments that he receives – regardless of the nature of the payment and whether or not there was an entitlement to the payment under the terms of the employment contract. It would also extend to any termination payments made by a third party and would also apply to the value of any amount that would otherwise be subject to tax on the writing off of a loan on the termination of employment.[16]

2.40 As a further simplification, the exemption could even be structured so that it applies against any employment income received by the employee in relation to that employment during the tax year in which the termination occurred. This therefore removes any need to examine whether the relevant payment relates to the termination or not. However, we suspect that this would be seen as creating scope for abuse (though the link to statutory redundancy gives considerable safeguards to HMRC) so we would accept that the exemption would not apply to the employee's normal salary for work done or completed before termination.

Summary of how statutory redundancy works

2.41 A statutory redundancy payment is due where an employee is made redundant with at least 2 years' service. Statutory redundancy pay is calculated as the total of:

- ½ a week's pay for each complete year of service where the employee's age during year is less than 22,
- 1 week's pay for each complete year of service where the employee's age during year is between 22 and 40, and
- 1 ½ weeks' pay for each complete year of service where the employee's age during year is 41+,
- A week's pay cannot exceed a specified figure (currently £464 from 6 April 2014). The minimum is 1 week per year of service up to a maximum of 12 weeks. Service longer than 20 years does not count.

[15] Under section 309 ITEPA 2003

[16] Under s 188 ITEPA 2003 An amount previously chargeable in full could become partially chargeable depending on the individual's circumstances. An amendment to s188 ITEPA may be required to reflect this.

- For this tax year, the maximum value of statutory redundancy pay that an individual can receive is £13,920.

Box 2.A: Worked example

A 31 year old employee has been working for her employer for 5 and a half years, at a weekly pay rate of £487.50 per week. She receives a statutory redundancy payment of £2,320. She also had a contractual right to a payment in lieu of notice, for which she receives £4,875. Her total termination payments are therefore £7,195.

Assuming that the exemption value is 3 times statutory redundancy entitlement, £6,960 of her termination payments would be exempt from tax, and she would be taxed on the remaining £235.

In comparison to this, under the existing regime, she would only qualify for a tax exemption in respect of the £2,320 statutory redundancy payment, and therefore would have been subject to tax on the remaining £4,875.

Value level of statutory redundancy exemption

2.42 Under this proposal, the level of the exemption would be a multiple of the statutory redundancy payment that the relevant individual is entitled to. The employer would need to calculate each employee's exempt threshold individually, but as they have to calculate statutory redundancy in any event, this is hardly an additional burden. Alternatively, as the exemption would apply in a smaller number of cases, it could be a flat amount – i.e. as at present, but with the amount properly indexed to a modern level (which is a suggestion made to us by many advisers in our meetings with them).

2.43 Clearly, the level of the exemption will have cost implications for the Exchequer; sustainability, indexation and costs in the long term will be relevant when determining the amount or the multiple. The proposed consultation would consider in detail what level would be appropriate.

Rationale and benefits of statutory redundancy exemption

2.44 Returning to the original rationale of the exemption, this was clearly designed with a loss of job by an average employee in mind. There is a case for equating this with a position for entitlement to statutory redundancy. Both employment law and HMRC practice have tended to treat redundancy differently from terminations in other circumstances, and therefore we consider that there is some sense in the tax treatment following this approach, not least because a common approach between employment and tax law is surely sensible.

2.45 In the case of employment law, there is a recognised statutory definition of redundancy [17] and, where the criteria outlined above have been met, this will trigger a right to receive statutory redundancy pay. This statutory right has distinguished these redundancy situations from all other types of termination.

2.46 HMRC practice differentiates between redundancy and other types of terminations. For example, HMRC will also allow for applications for clearance for redundancy schemes whereas for any other form of termination they will only consider these on an informal basis[18].

[17] Under section 139 Employment Rights Act 1996
[18] HMRC Statement of Practice 1/1994

2.47 The statutory redundancy regime is already well understood and recognised by employers and advisers. Linking the income tax exemption to this regime should therefore be a change which employers are able to adapt to relatively easily. Tying the income tax exemption to the level of statutory redundancy payment that the employee is entitled to has two key advantages:

- There is inbuilt protection against abuse, in that the tax reliefs will only be available to the extent that statutory redundancy is available. So any attempt to generate repeated redundancy situations, as outlined in the previous section, would presumably attract no statutory redundancy and so no tax relief.
- Unlike the existing exempt amount for termination payments, it is less vulnerable to becoming outdated, provided that the tax legislation is drafted appropriately to link to the statutory redundancy levels.

Considerations for statutory redundancy exemption

Certain types of payment will no longer be able to qualify for tax relief

2.48 This proposal involves a narrowing of the circumstances in which the exemption applies so that particular types of payments which would previously have been able to benefit from the £30,000 exemption will no longer be able do so, unless they are paid to someone who qualifies for statutory redundancy. Examples of this include:

- unfair dismissal awards[19]
- damages payments for wrongful dismissal[20]
- discrimination payments which compensate for financial loss[21]
- protective awards made under Section 189 of the Trade Union and Labour Relations (Consolidation) Act 1992[22]

2.49 Employment law requires that a compensatory payment is made to an employee in these circumstances. There is an argument that any payment made pursuant to a statutory employment right should be tax exempt, rather than only giving statutory redundancy special tax treatment.[23]

There are three possible routes:

- specifically add some or all of these situations to the payments that qualify for the exemption, with the connotation that the statutory multiple will apply;
- specifically provide for some or all such payments to be free of tax;
- accept that the value of these payments to departing employees would be reduced by the tax that they would now have to pay on them.

If either of the first two routes applied, it would clearly add an element of complexity to the overall regime compared to if the exemption was linked to statutory redundancy only. We also anticipate that other complications would arise from this extension, for example as regards whether tax relief should be available to employees who have a right to compensation in the

[19] Payable under the Employment Rights Act 1996, section 118. In its manual EIM 12960 HMRC has confirmed that these are subject to section 401 and therefore able to benefit from the £30,000 exemption

[20] See EIM12970

[21] See EIM12965

[22] In its manual EIM02550 HMRC has confirmed that these are subject to section 401 and therefore able to benefit for the £30,000 exemption

[23] Currently, there is also scope for a tax free payment where an individual has employment terminated on account of illness, injury or disability (under section 406 ITEPA 2003). This would not qualify for statutory redundancy, but arguably should still benefit from tax relief. (We consider this below).

circumstances but who nevertheless agree to a settlement payment rather than going to court. We would expect the consultation to consider these options and their implications.

2.50 We have heard from some people that they would like to see any revised income tax exemption extend automatically to any non-contractual payments in lieu of notice ('PILONs'). However, if the aim is simplification then we do not believe that this would be appropriate. PILON payments are rather different in nature from the types of payments described above. If our starting point is that all termination payments are taxed, it is simpler for all PILONS – whether contractual or non-contractual to be treated in the same way. This also removes any need to consider whether the payment arises from the contract or not.

Who would gain from a statutory redundancy exemption?

2.51 Having a general exemption that applied in all (statutory) redundancy situations would benefit some employees who, although losing their job, do not get the advantage of the exemption. Those might be:

- those with a PILON clause in their contract
- those approaching retirement age where HMRC argue that the payment is an unapproved retirement benefit scheme, and
- those where HMRC mount a successful 'autoPILON' argument.

Disadvantaged individuals

2.52 At present, certain individuals are prevented from qualifying for statutory redundancy rights. We have identified that the following groups fall in this category:

- Groups of employees who are excluded from statutory redundancy pay rights, including:
    - Individuals who are covered by an exemption order under section 157 Employment Rights Act 1995;
    - Members of the civil service and those employed in public office[24] and parliamentary staff;[25]
    - Members of Parliament;[26]
    - Government employees of any overseas territory;[27]
    - Household servants and domestic staff who are closely related to their employer;[28]
    - Share fishermen and women;[29]
    - Employee shareholders.[30]

[24] See Employment Rights Act 1996 section 159
[25] See Employment Rights Act 1996, sections 194 and 195
[26] Employment Rights Act 1996 section 159. But under ITEPA 2003 section 291 no liability to income tax in respect of earnings arises by virtue of any grant or payment when ceasing to hold office.
[27] See Employment Rights Act 1996, section 160
[28] See Employment Rights Act 1996, section 161
[29] See Employment Rights Act 1996, section 199
[30] As introduced under section 31 of the Growth and Infrastructure Act 2013

- Office holders who do not work under a contract of employment. These individuals can currently benefit from the £30,000 exemption but do not qualify for statutory redundancy.
- Individuals who have less than two years' service and / or who are under the age of 22 and therefore do not qualify for any statutory redundancy payment.

2.53 If the income tax exemption was linked to statutory redundancy situations only, those listed above will be unable to qualify for a tax relief on their termination payments when they might otherwise have done so under the current regime. The proposed consultation should examine which other groups might similarly be impacted and, in all cases, whether the new exemption should be structured so that it can nevertheless extend to some or all of them.

Conclusions on statutory redundancy exemption

2.54 As outlined above, although the "blanket" approach to an exemption may well offer some simplification and greater fairness to all, its value threshold may need to be set so low as to significantly reduce its benefits. Linking the exemption to statutory redundancy instead could allow a valuable exemption to continue to be made available, albeit in narrower circumstances, with greater clarity and certainty for all. For these reasons, we consider that a statutory redundancy exemption is more likely to be able to achieve the simplification that is needed. Our preference is to allow a multiple of the statutory amount as qualifying for exemption (rather than a flat amount). We do not make any recommendation as to the 'multiplier', simply that the exemption would be framed in terms of the statutory redundancy amount and up to (say) three times that amount in addition.

2.55 The resulting level of exemption may be under £30,000 in many cases. This would need careful explanation as the perception could be that there is a cut in a relief, though as we have noted, the way the rules currently work is that many fewer people benefit from the relief than is generally believed. The package would need to be presented as reform and simplification that would in practice be more generous to the average employee (as more would qualify for exemption).

Review of other income tax exemptions to section 401

2.56 Our review has also involved looking at the legislative provisions which supplement the £30,000 exemption in order to provide full tax relief on certain termination payments (rather than just a relief which applies up to the first £30,000).

2.57 Sections 401 to 403 ITEPA 2003 have the effect that any payments or other benefits which an individual receives in connection with his termination of employment are subject to income tax to the extent that together they exceed £30,000. Various exemptions, reliefs and reductions are available in relation to this charge so that the payment is completely tax-free (or subject to reduced tax), regardless of its value. A brief summary of each of these appears in the box below.

Box 2.B: Exemptions, reliefs and reduction in addition to the tax free threshold

Death - Section 406(a) ITEPA 2003

Exception from tax under section 401 for payment or benefit given when employment is terminated by employee's death.

However, note that a payment made on an employee's (or ex-employee's) death may be chargeable under Section 394 ITEPA 2003 instead if a non-approved or employer-financed retirement benefits scheme exists. HMRC now takes the view that any "arrangement" by an employer to make such a payment to an employee constitutes a retirement benefits scheme. Unless the employer has obtained HMRC approval for this "retirement benefits scheme", the ex gratia payment is therefore fully taxable.

Injury and disability - Section 406(b) ITEPA 2003

Exception from tax under section 401 where a termination (or change) payment or benefit is given wholly on account of physical injury to, or disability of, an employee.

HMRC's interpretation of this is felt to be unclear as to whether the exemption can apply or not. In Horner v Hasted, it was held that the relevant payment must be not merely in connection with the termination, but also on account of the employee's disability. In practice, a payment is regularly referred to as also being in respect of potential employment claims. HMRC tends not to follow its own guidance at EIM13637 and instead will take the view that, as the payment is not solely on account of the disability, it does not fall within the exemption.

Lump sum from retirement benefit scheme - Section 407 ITEPA 2003

Exception from section 401 for a lump sum or other benefit from a tax-exempt pension scheme if it is:

- paid in compensation for loss of employment or loss or diminution of earnings and the loss or diminution is due to ill-health, or
- properly regarded as earned by past service (ie: it is part of the retirement benefits).

Note that it does not exempt lump sums from a non-approved scheme.

Lump sum from overseas retirement benefit scheme - Extra-Statutory Concession A10

Exception from all income tax charges, and therefore from section 401, for a lump sum from certain overseas pension schemes.

Indemnity insurance - Sections 409 and 410 ITEPA 2003

- Certain office holders and employees may face legal action in respect of their actions. Where a payment or benefit is received in respect of such liabilities, it is excepted from charge under section 401 if it is:
    - In cash form and is given to meet the cost of a deductible amount which the individual pays and a deduction for that amount would be allowed under section 346 ITEPA 2003 if the individual still held the employment when it was paid.
    - In non-cash form and represents a benefit equivalent to the cost of paying such an amount.

Benefit from an overseas territory - Section 412 ITEPA 2003

An exception from section 401 for a benefit from a pension scheme administered by the Government of an overseas territory (see below) within the Commonwealth and a payment for loss of career, interruption of service or disturbance made to a public servant of such a territory in connection with any change in the constitution of that territory.

H M Forces payment - Section 411 ITEPA 2003

Exception from section 401 for a payment or benefit provided under a Royal Warrant, Queen's Order or Order in Council to a member of HM Forces by commutation of an annual or periodical payment under such a Warrant or Order to a lump sum or under certain schemes established under the Armed Forces (Pensions and Compensation) Act 2004.

Contribution to approved retirement benefits scheme - Section 408 ITEPA 2003

Exception to section 401 on any payment made by the employer for the employee's benefit into a tax-exempt pension scheme or into an approved personal pension scheme as part of the arrangements on termination of employment.

Payment to meet legal costs connected with termination - Extra-Statutory Concession A81

If the employer agrees to pay legal costs incurred by the employee in connection with the termination (whether in respect of negotiation between the parties or by court proceedings), this would ordinarily fall within section 401. However, a concession to make this payment free of tax applies provided that various conditions are met.

Note that this applies only to legal costs and not any other professional costs (eg: accountants). There is also a lack of clarity as to whether certain costs are covered (eg: legal advice in relation to the treatment of share interests following the termination).

Outplacement counselling - Section 310 ITEPA 2003

Particularly in redundancy cases, employers often offer outplacement counselling on termination, which takes the form of professional advice and assistance designed to help the employee cope with the situation and find a new job. Provided that specified conditions are met, these services (including fees for such provision) are exempt from tax, as well as associated travelling expenses.

Additional lump sum compensation payment - EIM13747

In 1987 the rules for redundancy payments for civil servants were changed so that some civil servants then under age 40 acquired reserved rights which gave them an additional lump sum compensation payment (often termed an ALSCP). Part of this ALSCP compensates for the loss of items that would have been exempt from tax as benefits from a statutory retirements benefit scheme (the Principal Civil Service Pension Scheme). So that part is also treated as exempt. The same exemption is available to employees transferred out of the civil service who retain those rights. The calculation of the exemption is complex.

Foreign service exception and reduction - Sections 413 and 414 ITEPA 2003

A payment or benefit is excepted from charge under section 401 if it relates to an office or employment that includes certain periods of foreign service. To establish whether this exemption is due it is necessary to establish the date of termination and then establish the amount foreign service during the employment up to that date.

If an employee whose service includes foreign service fails to satisfy the conditions for full exception, the employee might still qualify for a reduction in the section 401 charge. The £30,000 threshold must be deducted before calculating the reduction. The resulting amount charged to tax is reduced if qualifying conditions are met.

The amount of the reduction is the amount charged to tax multiplied by the length of foreign service and divided by the length of total service before the termination date.

Complex calculations can result.

Benefits connected with taxable cars and vans and HGVs, mobile phones and computer equipment - Section 320 ITEPA 2003, Section 319 ITEPA 2003 Sections 238, 239 and 269 ITEPA 2003

Exemptions apply to these benefits when given as part of a termination package. They are benefits that would be exempt if given during employment.

MPs and other elected representatives – Section 291 ITEPA 2003

General exemption of the grants paid on loss of office on election, which would otherwide be taxable under PILON principles as being contractual.

2.58 We have looked at each of these reliefs in the context of trying to simplify the current regime. Our view is that if some of these were removed it would offer significant opportunities for greater clarity and ease of operation of the regime. They are also reliefs which may no longer be appropriate. Such considerations are really policy matters so strictly beyond our remit.

2.59 We therefore propose a formal consultation to review the existing exemptions, reliefs and reductions which apply to the charge under s 401, in order to establish in each case whether they should be retained as part of the wider reform of the income tax treatment of termination payments.

Rationale and benefits

2.60 In our meetings with stakeholders and representative bodies, there has been a considerable amount of criticism in relation to the operation of certain of the current exemptions. The particular points raised are detailed below, along with our views in each case.

Death – exemption under section 406(a) ITEPA 2003

2.61 Notwithstanding this exemption, a payment made on an employee's (or ex-employee's) death may be fully taxable[31] (other than death by accident during service). The reason for this is that HMRC now generally takes the view that any "arrangement" by an employer to make such a payment constitutes a retirement benefits scheme. Therefore, unless the employer has obtained HMRC approval for this "retirement benefits scheme", the ex gratia payment is normally fully taxable. As such, there seems little point in retaining this exemption if it has effectively become redundant in practice.

Injury or disability – exemption under section 406(b) ITEPA 2003

2.62 The proper interpretation of when this injury / disability exemption can be relied upon is often a problem area for employers and their advisers. HMRC's position is viewed as unclear on this, particularly where the relevant payment has been made not merely in connection with the

[31] Under section 393B(1)(b) ITEPA 2003. See also EIM3600

termination but also on account of the employee's disability. In practice, a disability payment is regularly referred to as also being in respect of potential employment claims. In such circumstances, HMRC have sometimes taken the view that the payment is not solely on account of the disability and therefore cannot benefit from the exemption. However, this does not follow case law interpretations of how the exemption applies, nor HMRC's own guidance on this point.[32]

2.63 HMRC does offer clearance checks on the extent to which the exemption will be available for a particular payment. We have been told that this is generally a helpful service, but that the 28 day turnaround that HMRC offer is often not swift enough in practice, and there is often complexity in pulling together all of the medical reports and other evidence needed in order to get clearance. Many employers simply do not want to incur the costs of going through the clearance procedure, and therefore decide instead to apply the £30,000 income tax exemption and then withhold tax on the excess – often leaving the employee in a situation where he has paid too much tax and needs to claim a refund.

2.64 Although potentially a draconian approach, a removal of the exemption altogether would remove this as a problem area and provide simplification of the regime as a whole. In addition, if it was decided to remove the exemption for a termination payment on death (as referred to above), there seems little good reason for exempting a termination payment due to illness or disability.[33]

2.65 For both death and disability payments, it is clear that there is a 'fairness' argument for continuing with the exemptions. Our concern is that at present the exemptions are little used so if the decision is to continue with them, there needs to be a review to ensure they are targeted appropriately.

Legal costs – exemption under section 413A ITEPA 2003

2.66 Advisers have told us that there is often some uncertainty as to whether the relevant legal advice was specifically in relation to the termination (for example, advice in relation to treatment of share awards). One possible answer to this issue would of course be to remove the exemption altogether. Failing this, there should be either some amendment to the legislation in order to clarify this point, or alternatively the application of this exemption should be made clearer with more detailed HMRC guidance.

Foreign service – exemption and reduction under sections 413 and 414 ITEPA 2003

2.67 Under these provisions, if the relevant employment included foreign services then there may be an exemption from or reduction in the tax due on the termination payment.[34] However, we have been told that there are complexities with this relief as:

- It is complicated to work out what consists of "foreign service" for these purposes.[35]
- It is vital to work out when the relevant employee left the UK and when he returns, and what his tax status was during that time period, which can present difficulties for the employer.

[32] See Horner v Hasted and EIM13637, which states that HMRC will accept apportionment on a just and reasonable basis where the facts indicate that the payment has its source in both the disability and the employee's claim.

[33] Although there are exemptions under section 393B(3)(a)(b) for retirement due to ill-health, disablement and death by accident during service. We also note that there are often tax free payments on death under registered pension schemes with life cover. Therefore we acknowledge that the current regimes that apply on death and injury / disability are not identical and a direct comparison between the two may not be appropriate on this basis.

[34] Any payment which falls within section 401 ITEPA 2003 which exceeds £30,000 is normally subject to UK tax, regardless of where the individual is resident when the employment ends.

[35] For tax years up to and including 2012-13: Foreign service is broadly a period when the employee was not both resident and ordinarily resident in the UK. For tax years from 2013-14: Foreign service is a period during which the employee performed duties abroad and had earnings in relation to those duties to which section 15, ITEPA 2003 did not apply.

- Where claiming a reduction under section 414, only the employee can claim this and therefore the employer should not take the reduction into account when operating PAYE.
- The impact of any tax treaty needs to be checked, but this is often difficult.[36]
- We have been told that the tax treatment is particularly unclear in cases where an employee relocates overseas, having been employed in the UK for a number of years, and then receives a termination or redundancy payment. The timing of the payment is also very relevant as the ex-employee may have begun residence in a different country by the time the payment is made, and/ or a new tax year may have started.

2.68 Due to these complexities, HMRC have told us that some employers 'play safe' and do not apply the relief to the termination package being made at all.

2.69 Removing this relief could well result in simplification for employers. However, if a person has been working abroad for a number of years and then moves to the UK for a year before their employment is terminated, fairness seems to dictate that there should be a reduction in the amount on which he is taxed as the majority of his termination payment relates to work that he did not carry out in this country. Against that, he has presumably been out of the UK and not taxed on his salary for many years and a termination soon after return would be open to structuring to attract payments before the return if that brought tax advantages.

2.70 We have also heard criticism of the fact that there is no territorial limitation under section 401 ITEPA 2003, unlike most of the employment income tax code. This means that a person who is not tax resident in the UK can still be subject to tax on his termination payment under section 401 ITEPA 2003.[37] Many employers and employees can be caught out by this. We feel that it would be simpler to impose a limitation on the operation of Section 401 so that for example, once you have been out of the UK for a specified number of years, any termination payment that you receive will be entirely out of the scope of UK tax[38].

2.71 Simplification suggests that foreign service tax relief is removed, but again we recognise policy considerations and fairness need to be explored further. If it is desired to retain the relief, we recommend that consultation explores ways in which it might be simplified.

Considerations and impact of our review of the exemptions and reliefs to s 401

2.72 Although we are looking at these exemptions purely in the context of simplifying the regime, we appreciate that there are some major sensitivities and policy considerations in this area. Our aim is simplification and we have pointed ways in which the current unsatisfactory position can be improved. We would hope that a consultation on this will allow for a better understanding of the possible impact of any changes, and, where removal is found not to be appropriate, to explore ways of simplifying their practical operation.

2.73 If the outcome of consultation is that any of these exemptions and reliefs should be retained, then their current complexities will still need to be addressed. We would hope that the application of many of these can, in the first instance, be improved through better HMRC guidance and a more consistent approach from HMRC as regards the circumstances in which each exemption is considered to apply in practice.

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[36] Although the Organisation for Economic Cooperation and Development has been reviewing this in order to provide clearer guidelines on this area.

[37] See HMRC manual EIM13050

[38] This would need to be subject to anti-avoidance provisions to protect against circumstances where there is a termination of employment abroad and then a re-engagement in the UK.

Proposals for reform of the national insurance contributions treatment

2.74 Under the current system, termination payments that qualify to be taxed under section 401 ITEPA 2003 are tax-free to the extent that they do not exceed £30,000. However, they are completely NICs free, regardless of value. This has its origins in the definition of earnings for NICs purposes but does produce a disconnect between the income tax and NICs treatment of such termination payments which seems illogical. We have therefore been looking at whether aligning the income tax and NICs regimes for termination payments would be an appropriate simplification of the regime.

2.75 In our meetings, we have received mixed feedback as regards how often employers make errors in this area. HMRC and others have told us that in practice they have rarely come across this as a problem. However, some advisers have emphasised to us that this is a major area of confusion, even amongst advisers themselves, and that therefore there are clear arguments for an alignment of the income tax and NICs rules.

2.76 The OTS has regularly recommended alignment of income tax/PAYE and NICs rules and thus alignment of the treatment of termination payments has logic on its side. It would offer a measure of additional simplification. Clearly, for those termination payments which qualify for income tax relief up to the value of the £30,000 exemption and are therefore subject to income tax on the excess, additional revenues would be raised if NICs was also imposed on the excess. This would presumably be a consideration to be weighed when considering measures that would widen the availability of the basic exemption.

2.77 We therefore propose that the consultation on reform of the income tax treatment of termination payments should include a review of whether there should also be a reform to the NICs treatment, so that the two regimes are aligned.

2.78 We assume that any such alignment of income tax and NICs would operate so that Class 1 (employee and employer) NICs[39] would apply on a termination payment, though it would presumably be possible to lay down that only secondary contributions would apply. That would introduce a further illogicality, however, NICs would potentially operate as follows:

- in circumstances where an income tax exemption is available, there is a NICs exemption which applies on the same value of the termination payment that is exempt from income tax; and
- to the extent that the termination payment exceeded the value level for income tax relief, and therefore the excess is therefore subject to income tax, that excess value is similarly subject to NICs.

Considerations and impact

- An alignment of the NICs treatment with the income tax treatment would benefit the Exchequer – particularly in relation to the additional employer NICs that would result. As referred to above, this may be a way of balancing any Exchequer costs that arise as a result of proposed changes to the circumstances and threshold of the income tax exemption.
- However, imposing NICs on all termination payments which exceed the income tax exemption will have a real cost impact for employers as well as departing

[39] Or Class 1A NICs on any element of the termination payment that is a benefit which would normally be subject to Class 1A NICs if given during the employment.

employees. Nevertheless, if the income tax exemption was applied in circumstances of statutory redundancy only but with a higher threshold at which it kicked in then the costs impact overall may not be significant other than in cases of particularly high-value payoffs.

- With income tax being collected on a cumulative basis throughout the tax year and NICs being only concerned with what is being paid for the pay period, we understand that there may be some difficulties with aligning the two regimes. Applying NICs on an annual basis would involve a fundamental change to the NICs regime, including issues around the contributory entitlement. However, it is reforms in these areas that we have previously recommended as desirable as they would pave the way for alignment of income tax and NICs. We think termination payments could be a test bed for aligning tax and NICs rules[40].
- There may be further complications in relation to overseas employees, as a person could opt to stay in the UK NICs scheme. There are also special rules for residents of the EU and reciprocal agreements which are not replicated for income tax and will need to be considered.

These points should be explored further as part of the proposed consultation.

Interim measures

2.79 In the meantime, and in addition to the quick wins we set out in our interim report,[41] we believe that some simplification can be achieved relatively quickly through a small number of changes to the current system. These are set out below, and are areas that HMRC can make progress during the course of the current government.

HMRC policy and guidance:

2.80 The feedback that we have received has indicated that there are a number of areas in which clearer HMRC guidance would greatly assist employers and their advisers. We consider that this needs to be addressed now in order to make the existing regime easier for employers to administer. The relevant areas are highlighted below.

Auto PILONs

2.81 HMRC takes the view that where the employment contract does not include a right or discretion for the employer to make a payment in lieu of notice (a "PILON"), but the employer habitually makes a payment for any notice period that is not worked then, provided that it is not a damages payment, the payment may be earnings[42] if this payment could be considered to be an "automatic response" to the termination. However, HMRC also assert that in these circumstances if there is a procedure for making a critical assessment in relation to each payment, then it cannot be argued that the payments are being made automatically.[43] As a result, employers feel under pressure to put additional processes in place in order to be able to demonstrate that a critical assessment has been carried out in each case. This is time consuming and costly for businesses; it leads to the well-advised businesses obtaining the exemption for departing staff whereas another business may not.

[40] We note that certain types of payments, such as payments under restrictive covenants, are already deemed to be earnings for NICs purposes.
[41] https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-interim-report
[42] Within Section 62 ITEPA 2003
[43] See EIM12977

2.82 This burden for employers has been consistently raised as an issue in our stakeholder meetings, particularly as many advisers feel that HMRC's position does not have sufficient legal basis. Questions have been raised on HMRC's views regarding:

1 Whether a payment which is made a matter of routine is prevented from being categorised as compensation or damages (which are normally able to benefit from the current £30,000 exemption). Where an employer makes a payment because it has failed to give the employee notice, advisers argue that payments made in these circumstances can still qualify as damages payments - even if they are made as a matter of routine (as confirmed by case law [44]). Our understanding is that HMRC tend to disagree and treat them as arising from the employment contract, even where there is no employee understanding or expectation that he will receive such a payment. Advisers are questioning the basis for this policy and asking that HMRC relax its position on it.

2 The factors which should be taken into account in determining whether the payment is a damages payment or not. HMRC guidance states that if a PILON is made solely due to the termination of that employment (and there is no contractual right, or expectation by the employee that a PILON will be made) then broadly it will be considered a damages payment to which s401 ITEPA 2003 will apply. However, in practice HMRC's approach tends to be that a non-contractual PILON payment is not a damages payment unless it is calculated by reference to the principles relating to the calculation of damages[45]. However, in practice employers now often calculate damages based on gross pay, as they see this as the appropriate amount in order to avoid a claim by the former employee. Where a payment is calculated in this way, HMRC often sees this as indistinguishable from a contractual PILON. There is therefore a view that HMRC should revise its stance about when a payment constitutes a damages payment, taking current commercial practice into account. We acknowledge that if HMRC revised its position on this issue, this will have cost implications for the Exchequer, as it will have the result that payments that have previously been treated as taxable earnings may instead be able to qualify for tax relief.

2.83 Nevertheless, we recommend that HMRC revisits its position on the circumstances in which an autoPILON is considered to have been paid, with a view to

1 relaxing its requirements that a critical assessment needs to have been made in order for a payment not to qualify as one and

2 setting out the factors that are relevant in determining whether a payment is a damages payment, taking into account current commercial practices.

Payments around retirement age

2.84 We have heard many times that situations where an employee aged 55 or over (or even 50 or over) departs, then HMRC will argue any payoff is regarded as an 'unapproved retirement benefit scheme'. Whilst we understand why HMRC raise the issue, we think that the policy needs to be re-examined to ensure it reflects current working practices and law, in particular:

- the abolition of the default retirement age

[44] SCA Packaging v HMRC [2007] EWHC 270 (ch)

[45] For example, reducing the payment to reflect the fact that the employee had secured alternative employment before the end of the notice period and therefore reduced the loss caused by the employer's breach. See EIM13070.

- the increasing tendency of older workers to continue working well past 60

2.85 We therefore recommend that HMRC guidance is clarified and updated in order to reflect appropriate current situations.

Income tax exemption on injury and disability under section 406(b) ITEPA 2003

2.86 As referred to above at 2.62, the HMRC guidance on the application of this exemption is unclear and does not reflect the views that they tend to take in practice. As outlined above, there may also be scope for simplifying the current clearance process.

2.87 We therefore recommend that HMRC guidance is clarified and updated in order to reflect their policy on how the exemption in section 406(b) ITEPA 2003 applies, and that HMRC gives consideration to ways in which its current clearance process may be improved.

Treatment of termination payments under the 'disguised remuneration' legislation

2.88 We have also been told by advisers that there is uncertainty regarding whether termination payments made by someone other than the employer are able to benefit from the £30,000 income tax exemption (and NICs free treatment). Payments by third parties are potentially subject to the "disguised remuneration" charges which appear at Part 7A of ITEPA 2003. At present, where a termination payment is subject to the charging provisions under Section 401, the legislation specifically allows the £30,000 exemption - but this exemption for termination payments is not replicated in the disguised remuneration rules.

2.89 It is sometimes the case that a person other than the employer – such as an owner of the business – chooses to make a payment to a departing employee, for example for personal compassionate reasons or to support company cashflows. If the payment had been made by an employer instead, then the tax position would be clearer, as any such payments falling within section 401 will be able to benefit from the £30,000 exemption. However, if the payment is made by the owner direct to the employee (and borne by that owner and not recharged to the employing company), the disguised remuneration rules potentially apply instead – with the resulting uncertainty as regards whether the £30,000 exemption is available.

2.90 HMRC has issued guidance which suggests that the disguised remuneration and section 401 charging provisions are mutually exclusive, and therefore if a payment falls squarely within section 401 then it will not be subject to Part 7A. However, advisers have expressed concerns to us that there are clearly cases where the position will not be so clear, and potentially the termination payment could be considered to meet the criteria for a Part 7A charge to apply. We therefore consider the legislation needs to be amended in order to address this lack of clarity,[46] failing which there should be firmer and clearer HMRC guidance.

HMRC support

2.91 We have heard some criticism from employers and agents of the level of support that HMRC provide in relation to termination payments, including that they are slow to respond on queries, and sometimes provided inconsistent, uncommercial – or simply strange – responses.

2.92 Many have expressed a wish to us for a more centralised and publicised clearance procedure at HMRC for termination payments generally, with a larger pool of HMRC specialists on this particular area. Advisers who already have a detailed knowledge of the legislation and guidance, and who have a breadth of experience in this area, occasionally need to raise queries

[46] For example, through the use of a carve-out that operates in a similar way to those under sections 421B(3) and 471(3), which provide carve-outs from, respectively, Chapters 1 to 4A and Chapter 5 of Part 7 of ITEPA if the right or opportunity is made available by an individual in the normal course of the individual's domestic, family or personal relationships.

with HMRC on particular technical points. At present it is felt that there is no clear point of contact at HMRC where such queries can be appropriately dealt with by an HMRC technical adviser with sufficient knowledge and experience in relation to termination payments.

2.93 It appears that many termination payment queries are dealt with by a number of different parts of HMRC (such as HMRC contact centres, the Centralised Employers team in Longbenton, customer relationship managers in Large Business Service, or the Personal Tax Operations team), rather than deferring to a central team which is specific to this area. This may explain some of the inconsistent responses that advisers receive from HMRC, although we are told that the HMRC 'backstop' for termination payments queries is the technical team based in Solihull and HMRC staff are aware of their existence and use them.

2.94 Nevertheless, we believe that a more streamlined, centralised support system at HMRC could potentially improve the current regime's operation.

2.95 We therefore recommend that HMRC carries out a review of the way in which it currently deals with queries on termination payments internally, in order to understand how extensively this issue is raised and how efficiently HMRC deals with such queries, with a view to HMRC then carrying out a costs and benefits analysis of having a more dedicated, centralised and publicised team specifically for termination payments queries.

2.96 We also recommend that HMRC consider whether there is scope to develop better guidance for employers: in simple terms, whether guidance on the website can be made more dynamic so as to reflect current queries, and possibly to offer interactive tools to help employers determine the tax treatment of particular types of termination payments (similar to those which HMRC offer on other areas, such as the employment status tool and the statutory residence indicator). We believe that although this will require investment from HMRC, there will be significant payback in terms of reduced queries and better compliance by employers and employees.

3 Other issues: follow up to Chapter 8 of the interim report

Introduction

3.1 The OTS's Employee Benefits & Expenses interim report published in August 2013 contained a lengthy chapter on 'Other Issues' – Chapter 8. The coverage was a wide range of some 25 issues that did not warrant a separate chapter or did not fit into the main chapters in the report. All had been raised in our evidence gathering sufficiently to prompt us to record concerns and in many cases make recommendations. Some were minor issues; some of these were raised sufficiently often to make them into significant matters. Some concerned major areas (e.g. cars) but were minor points in themselves.

3.2 It is pleasing to be able to record that some of the items in Chapter 8 have already been acted on by HMRC. A notable example is our recommendation on Trivial Benefits, the subject of a current consultation document.

3.3 This chapter needs to be read in conjunction with our original Chapter 8, though we have tried to include summaries where possible to enable sections to stand alone.

Key points

3.4 During our evidence gathering on our Competitiveness review and also the further work we have been doing on Accommodation and Termination payments, a number of the Chapter 8 issues have been raised in meetings. The main examples are (in order of frequency of the issue being raised):

- Removal expenses
- Long service awards
- Authorised mileage allowance payments (AMAP) rates

3.5 We therefore want to include in our current report a progress report on these Chapter 8 issues. We do so both to acknowledge the progress made by HMRC but also to highlight issues that do need attention. It is important that relevant reforms remain on HMRC/HM Treasury's agenda.

3.6 It seems to us that the main items that need attention are:

- Removal expenses: the current limit for removal expenses of £8,000 (before a taxable benefit is triggered) is outdated; simplification suggests that all removal expenses are 'allowable', balanced with provisions to guard against abuse. At a minimum, excess reimbursed removal costs should qualify for settlement via a PSA.[1]
- Long service awards: a more modern system is needed, more linked to current working patterns

[1] We have of course recommended in our previous report that the system of PAYE settlement agreements be significantly reformed. Although HMRC initially rejected the proposal, we hope that they will review the position once the current series of consultations is concluded.

- Entertaining, including aspects of subsistence, staff canteens etc: here we hope that responses to the current HM Treasury call for evidence on remuneration patterns and the planned consultations on Travel & Subsistence will generate further evidence of the practical issues in this area.

3.7 We are naturally conscious that a number of our suggestions in this chapter have a potential Exchequer impact, which will be a factor in Ministers' decisions on whether to take forward reforms. We have tried to highlight why we believe that reforms are needed and how they would simplify the tax system (and in some cases help wider policies).

General issues

Reliefs and exemptions

3.8 Since the publication of our report, the National Audit Office has carried out an exercise on Tax Reliefs for the Public Accounts Committee (PAC).[2] The PAC published a report on 26 June on its recommendations around reliefs. As we noted when the report was published, the OTS remains interested in the subject of reliefs and believes one of the most important issues is that they are kept under review against their policy objectives.

Out of date thresholds

3.9 A number of the thresholds we listed in Table 8.A are receiving attention:

- The £8,500 benefits threshold is the subject of a current consultation
- Those linked to terminations and accommodation are dealt with elsewhere in this report
- Many of the others are discussed later in this chapter

3.10 The general point we made – that there should be a commitment to periodic review and updating of thresholds to ensure their simplification benefits are not lost – remains valid.

Benefits

Beneficial loans

3.11 The increase in the de minimis limit to £10,000 in Finance Act 2014 has been widely welcomed.

3.12 We do think that consideration needs to be given to ways of facilitating payrolling for loans. This implies fixing the interest rate at the start of the year for the full tax year – so that if the loan balance is fixed, the benefit for the year can be anticipated.

3.13 Currently HMRC review the rates on a quarterly basis which gives employers a snapshot for determining the cash equivalent of the benefit for a period of three months. Annual advance fixing would have little impact where rates are settled (as now) but a period of rates volatility could carry adverse (or favourable) effects on taxpayers and the Exchequer depending on the direction that they were heading. But the simplification advantages of annual fixing, potentially facilitating payrolling, could outweigh cost issues on both sides.

[2] http://www.nao.org.uk/report/tax-reliefs/

Cars

3.14 The aim must be to facilitate payrolling of car benefits. That will help cure the issue we noted at para 8.16 of 'all too frequent errors in tax codes'. The advance fixing of CO_2 bands helps significantly[3] but the concern we have heard most from employers is that they will be expected to put through changes in company cars immediately and penalised if they do not. The system needs to build in a suitable period to allow changes – at least one pay month.

3.15 We think the 'de minimis' issue we noted in our earlier report around hiring cars for employees for short periods needs consideration.

3.16 The planned abolition of the tax disc will answer the plea from major fleet users for a simpler system and is a very welcome, simplifying initiative.

Car fuel

3.17 We raised the issue of allowing reimbursement of private fuel by 6 July after the tax year in question to obviate a tax charge. The legislation requires reimbursement in the year, though HMRC accept 'belated making good....where there has been an administrative delay or error', as they have confirmed in correspondence with the OTS. Our point was that it may not be possible to calculate the precise necessary reimbursement to avoid the fuel scale charge until the year end. HMRC have indicated to the OTS that this would be an acceptable reason for delayed reimbursement.[4] This needs to be publicised properly.

3.18 In making the points in the previous paragraph we agree with HMRC that the objective must be to encourage payrolling of cars and car fuel.

3.19 We repeat our comments at paragraph 8.24 about the provision of car fuel by fuel card. The rules around the use of fuel cards should be scrapped. It is difficult to see any negative impact, and people would face less irritation at the petrol station. We understand that HMRC are keeping this under review, though they note that there are contract law issues here which need to be considered.

3.20 We also repeat the point we made at 8.20 about the benefit implications of recharging electric cars. This is a general benefits question rather than a car fuel point[5]; for company cars it would be part of the ancillary costs but it would rank as a separate benefit if an employer provided a recharging point for employees' cars. This is likely to be an increasing issue and needs to be considered properly, presumably in the wider context of policies towards all electric or hybrid cars and could have revenue implications. In the meantime, a general update/statement from HMRC on the position of electricity provision might be helpful in clarifying matters for uncertain employers.

Mileage rates

3.21 As we noted in the introduction to this chapter, we have continued to hear calls for increases in AMAP rates. These are not universal but are certainly regular. Clearly an increase would have an Exchequer cost but we have heard regularly that the current levels do not reflect full current running costs even for 'ordinary' cars.

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[3] Chapter 8 of the Interim report contained comments about changes to the CO_2 bands (the appropriate percentage). HMRC point out that these changes are announced at least three years in advance and legislated for at least two years in advance. They go on to note that: "This is a case where ensuring the level of charge is a fair reflection of what the benefit is actually worth is driven by advances in technology. In five years, the number of car models with CO_2 emissions below 100 grams per kilometre has increased from three to several hundred. Changes in the way that company cars are taxed have been successful in driving down the average vehicle emissions, encouraging companies to turn to greener and more fuel efficient cars, and helping the UK move towards meeting its international carbon reduction commitments."

[4] A similar issue arises in relation to reimbursement of the car scale charge in the light of Section 25 Finance Act 2014.

[5] HMRC point out that electricity is not regarded as fuel and therefore does not come under the provisions of the car (or van) fuel benefit charge.

3.22 Where employers pay above the AMAP rates, there is a universal call for the tax to be settled through a PSA if the employer wishes.

Cycle to work schemes

3.23 The general impression remains that the scheme is administratively burdensome. The take up is generally low but it is very popular with those who use it. Despite drawbacks, the scheme has received strong support from the cycling community. In principle it encourages people to cycle, though we have been told that the main impact is in giving bikes to people who would cycle anyway (or don't use them much at all).

3.24 Particular problems include the 50 per cent commuting requirement (the policy aim is understood but the concern is that it is seen as unenforceable), VAT calculations, transferring the bike at the end of the period, and the £1,000 limit.

3.25 Evaluation of the scheme is needed, looking at the actual take-up figures (including how many are still cycling to work after the initial few months). This should include looking at ways to streamline administration. It could also be part of a wider review of cycling support.[6]

Late night taxis

3.26 We have made our points on late night taxis in two reports but accept that decisions have been made not to change the relief.

Long service awards

3.27 This is an issue that we have had raised regularly as a minor irritant. In summary:

- A 20 year minimum for tax exempt long service awards is too long.
- Many employers wanted to give awards more regularly than the rules allow.
- Some employers wanted to give vouchers.
- The 10 year interval rule (i.e. no previous award in the past 10 years) is claimed to be a source of unfairness.

3.28 The suggested reforms are:

- A 10 year minimum instead of 20 years
- Allow vouchers to be given (up to a maximum amount)
- Abolish the 10 year interval rule

[6] HMRC have commented on cycle to work schemes as follows.
"It may help if we set out the policy intention of introducing this scheme. There were a number of clauses (of which cycle to work schemes was one) supporting greener commuting and especially to help employers establish green transport plans. Therefore the primary policy intention is about use of the bike or cyclist's safety equipment for commuting rather than supporting an (albeit healthy) leisure past-time. As a result we think that the legislative requirement for the bike or equipment to be used 'mainly' for commuting journeys is a fairly reasonable one.
Of the other problem areas listed, we have the following comments:
VAT calculations - when the original legislation was enacted this was not a feature. However, the ECJ case of AstraZeneca determined that where an employer provides goods or services under a salary sacrifice arrangement, there is a supply for VAT purposes. As such judgements are binding on the UK there is no option but to apply their terms. HMRC has, however, provided extensive guidance and has, in addition, contributed to the DfT guidance on cycle to work schemes.
Transferring the bike at the end of the period - at the request of employer groups HMRC has published guidance on what we would consider to be fair market value on transfer. Employers do not have to use this guidance, but would have to demonstrate that the value they used instead constituted fair market value.
£1,000 limit - there is no actual monetary limit in the legislation or set by HMRC. This limit is a consequence of the growth of salary sacrifice arrangements. The Office of Fair Trading (OfT) has construed that any such payments fall within the consumer credit legislation. Most employers do not hold a consumer credit licence in their own right and therefore OfT has set a general licence cover of £1,000. Where employers hold a consumer credit licence in their own right the limit available can match the level of coverage given by it."

3.29 The problem is that in many ways the relief is not in line with today's employment patterns. (Because employees are more likely to move around in today's market, rather than staying for 20 years.) That might indicate abolishing the relief or reforming it to revolve around reward for high performance, though that would probably be complex and imply some form of bonus relief and accordingly we do not recommend it.

3.30 However, as the exemption is well established it is probably better to reform it to make it better fit today's working environment. An exemption based on high performance would be difficult to define. Relaxing the rules (e.g. moving to a 5 year minimum) would impact government revenue and increase avoidance risk but given the amounts of relief available we do not see this as a serious issue and so the outline in paragraph 3.28 would be our preferred route. We are, of course, conscious that there are revenue implications in what we are suggesting but as always we have simplification as our main objective.

Salary sacrifice

3.31 We assume that responses to the current HMT 'call for evidence' on remuneration practices will provide more evidence of current practices and inform possible actions.

Staff canteens

3.32 Again, it would be useful if responses to the HMT call for evidence and the planned Travel and Subsistence consultation generated more information about the provision of canteens and refreshments generally for staff. What we have heard is that the traditional staff canteen is increasingly rare, due to issues such as split sites, changing working patterns and cost. We do not have enough evidence to make recommendations but think that whether the canteen exemption is still the right basis for measuring an exemption these days, or whether there is a better route, is a question that needs to be debated.

Third party benefits

3.33 Do we need clearer guidance regarding third party benefits? Does this or existing guidance need to be better publicised?

Training

3.34 This is perhaps the most important area for consideration of policy objectives and evaluation of whether the current tax rules are delivering what policymakers want. Our evidence gathering suggests that the current rules are not delivering a clear policy. At the moment, aspects of the resulting tax rules cause confusion and perceptions of unfairness.

3.35 Work related training is not taxable if contracted by the employer or if incurred by the employee and reimbursed, but not deductible if not reimbursed. As we have discussed problems in practice (with businesses and advisers) the questions raised include:

- Should there be a deduction for non reimbursed costs?
- If so, in what circumstances – maintenance of skills? Updating? Development in new areas?
- Should the exemption be extended to skills other than those strictly related to the job?
- What would be the cost of extending the exemption?
- Can the risk of abuse be managed?

3.36 It seems to us that there is a need for a proper review in this area. Extending the exemption could encourage positive behaviour change ('up skilling') as well as simplifying the tax system. But we acknowledge that there are significant policy issues involved.

Transfer/use of assets

3.37 We noted a number of practical issues with the '20% rule'; HMRC have indicated that they will review their guidance.

3.38 The main issue seems to revolve around personal computers at work (see also para 8.43 of the interim report). A simplified tax regime on voluntary business use of personal computers could be considered, which might include a set allowance or at least clear rules on when a deduction would be accepted. This regime could incorporate the opposite scenario (personal use of business assets).

3.39 There could be an Exchequer cost impact and measures might be needed to prevent people abusing the regime. Our sense is that this issue is likely to grow in importance over the coming years.

Expenses

Entertainment

3.40 Our interim report noted some issues with the 'Christmas party' exemption:

- The 'Christmas party' exemption is still widely used. However, a number of employers say that they have stopped providing such an event, or make it something that divisions or locations can decide on separately.
- The 'cliff edge' causes problems. There is a lot of time spent on allocation of cost if a couple of events go over the £150 limit.
- HMRC say that smaller employers often treat the £150 as an allowance and try to PSA the balance (which is not allowed).
- There is a problem with one-offs, such as centenaries, or biannual events, as these are not going to be 'annual' (and therefore should not strictly qualify for the exemption).

3.41 There is of course a much wider issue around entertaining generally; for example:

- Some charities reported difficulty distinguishing between entertaining and marketing costs.
- There can be issues over distinguishing staff entertaining from client entertaining: how many of each (or what ratios) are needed?

3.42 In turn this links to questions about:

- the 'allowability' of lunches away from the normal workplace and how much should be allowed (some employers ask for benchmark rates)
- how this links to the traditional 'canteen' exemption (something that we note at para 3.32 is increasingly rare – but exemptions and lunch policies generally still seem to be based on the 'works canteen' model)
- subsistence amounts for overnight stays in hotels (questions over amounts allowable for dinner, particularly around alcohol)

- the availability of an overnight 'friends and family' allowance (which HMRC no longer accept because of concerns over whether the amounts claimed are actually spent)

3.43 We have continued to hear occasional comments about these issues, though these have not been constant. The general impression is of rules that are well known and managed, with the administrative burdens they cause accepted as part of life. It does seem to us that there is scope for a review that would consider the whole area properly and see if rules can be simplified/streamlined. This could potentially pose fundamental questions around:

- What is the policy rationale? The block on entertaining expenditure started in the 1960s as a reaction against perceived excessive 'City' entertaining.
- How well do the rules fit with today's trade/ business practices?
- How can rules on distinguishing client entertaining, staff entertaining and marketing be made clearer?
- Does the canteen exemption work properly these days?
- Is the Christmas social exemption right: Is the limit of £150 per head too high? Too low? Should the exemption be limited to annual events?

3.44 A review in this area inevitably risks a negative reaction among businesses, and in the media (seen as 'meddling' or taking away something valuable). But there are anomalies which should be addressed. It would be useful if responses to the Government's 'Call for Evidence' on remuneration practices provide evidence in the entertaining arena: that might provide more evidence on the need for a more focussed review in this area. The planned Government review on travel and subsistence is also likely to contribute usefully in this area (e.g. around overnight stays in hotels).

Fixed rate expenses

3.45 We are pleased that HMRC have undertaken to review this area and look at ways of improving the targeting and use of fixed rate expenses.

Pecuniary liabilities

3.46 HMRC would welcome any significant examples of problems in practice.

Personal incidental expenses

3.47 We have continued to hear occasional comments about the need to raise the standard amounts, usually in the context of international travel and particularly about laundry costs.[7]

Removal expenses

3.48 This is probably the most frequently mentioned 'other' issue that we have continued to hear about. It is often raised in the context of discussions about employee aspects of UK competitiveness.

3.49 The £8,000 limit on tax-free removal expenses is seen as very out of date: it covers 'rental to rental in the UK' moves, but nowhere near covers buying/selling costs. Many employers have said it is insufficient for international moves of any sort. One sector we heard a good deal from on the latter aspect is universities: they are encouraged to bring in well-qualified people from

[7] It has been pointed out that it can be cheaper to get a few shirts washed when away as opposed to paying for a suitcase on the plane!

overseas, who can then be faced with an unexpected tax bill for their reimbursed removal costs as soon as they arrive.

3.50 Inevitably, most said that the limit should be raised significantly or abolished (i.e. that any removal expenses should be seen as an allowable expense if reimbursed). It was accepted that there would need to be control to prevent abuse but the point is regularly made that employees rarely see being moved as a benefit.[8]

Box 3.A: Example of removal costs problems

As discussed at our meeting the taxation on removal costs is in my view now a significant barrier to mobility. The consequence of this is that it is difficult to recruit staff from wider in the UK and that there is a group of staff who operate south of the M4 from Bournemouth to Brighton so as not to move house.

This University typically only reimburses 10% of salary so that the stamp duty is often most of or greater then the tax free allowance, the effect of which is that individuals are paying tax on tax. In addition since it was introduced there has been significant house price inflation.

– Comments from the Director of Finance of a south coast University.

3.51 On a more detailed level, the 5 April requirement in section 274 ITEPA 2003 was seen as unfair as it gives widely differing periods in which the removal expenses can be incurred. One person asked why relocation expenses needed to be entered in three different places on the form P11D.

3.52 Although a simple increase in the £8,000 limit has merit, it would not address the underlying issues. Consequently, we think this is another area for a proper review. That review needs to test:

- What is needed in a modern day labour market (where people move around more)
- Should there be no limit on what is allowed – provided there is a clear business case for incurring the costs? Could a provision against abuse around controlling directors or similar positions give enough protection?
- Should there be a higher limit for highly skilled people relocating to the UK from overseas? (Although would this make things more complicated?)
- Is there an argument for special treatment for bodies such as universities? (Again, would this make things more complicated?)[9]
- This policy area needs to be better aligned with BIS and Home Office policy.
- Should there be a tax free allowance that people are free to spend as they wish? (Such as a moving allowance provided to doctors – but tax free.)
- It would be fairer to frame any rule in terms of 'expenses incurred within X months of commencement of the new duties'.

[8] This is another example of changing working patterns/practices: as we noted in our interim report, employees are much less likely to accept a move of location and automatically move their families than was the case (say) 20 years ago. Thus should a review look at the wider practices to judge whether the tax system is operating fairly? Again, the current Government call for evidence may contribute usefully.

[9] There is the potential for EU State Aid issues here if help was geared to particular sectors.

As noted, this needs to be seen as a competitiveness issue. Not taking action on this issue is likely to increase pressure in the long term.

Subscriptions to professional organisations

3.53 The extensive HMRC list of approved organisations works well, but can be slow to update. We noted questions about networking groups. This raises two issues, the simplification gain being to provide more clarity/certainty to bodies and employees.

3.54 Firstly, could subscriptions to organisations with a clear business purpose be allowed automatically, rather than have an HMRC approved list? In effect the organisation would have to self assess against criteria. There is a potential for abuse (how do HMRC check 'clear business purpose'...would that have to apply to all members?...how would HMRC recover tax relief if an organisation was disqualified?) but we think that in principle it offers a more modern route in keeping with the aims of the tax system.

3.55 If this route is followed, there would have to be an appeals procedure: HMRC would presumably 'disallow' a body which would then have the option of appealing to the Tribunal on the basis that they do have a clear business purpose.

3.56 Secondly, assuming the HMRC list continues, can it be kept more up to date? Could HMRC commit to providing an answer about new requests within a certain timeframe?

Uniform and clothing costs

3.57 We noted occasional problems and have had the issue raised occasionally subsequent to the publication of our report (e.g. in the hospitality industry). There is a need to ensure rules are clear and well publicised so people can make claims themselves, rather than relying on repayment agents who take a relatively high percentage of any tax reclaimed and also tend to cause problems for HMRC.

3.58 The problem around charity T shirts that we reported will hopefully be solved by the proposed trivial benefit exemption.

A Further statistics regarding accommodation benefits

The Family Resources Survey (FRS) is a survey of UK households commissioned by the Department for Work and Pensions (DWP). The FRS has sections on accommodation and questions whether accommodation is provided by an employer and also who the landlord of that accommodation is for rental accommodation.

The FRS uses a stratified random sample approach. The results from three years of FRS have been pooled (2009-10, 2010-11 and 2011-12) to increase sample size and reliability. The figures for each year have been compiled and then grossed up to be reflective of the UK population and the average across the three years is reported below.

Analysis

Across the three years, there are around 70,000 households surveyed with 500 living in accommodation which comes with a job.

This indicates that around 220,000 or 1 percent of households live in accommodation provided by an employer. These households account for around 2.5% of rental, rent free and part owned, part rented accommodation.

70,000 of these properties (30% of accommodation which comes with a job) are provided fully rent free.

Table A.1: Households with accommodation provided by an employer by accommodation status and rental status

Does employee make a contribution to rent?	Owned by employer	Not owned by employer	Total
No	60,000 (25%)	20,000 (7%)	72,000 (32%)
Yes	80,000 (35%)	70,000 (32%)	150,000 (67%)
Not known		Less than 10,000 (1%)	Less than 10,000
Total	140,000 (60%)	90,000 (40%)	222,000

For the 'not known' category, the amount of the employee contribution may be the entire rent or only part.

The armed forces, religious organisations and agricultural labourers are all excluded from paying tax on employer provided accommodation. These groups made up around 35% of respondents with employer provided accommodation. This equates to 80,000 households when grossed up. However, it is possible that the definitions here do not tally with the HMRC exemptions. For example, horticultural labourers may be included in the agricultural group and horticultural labourers will not generally be able to qualify for tax exempt accommodation. As a result of this, the figure of 80,000 may be over-stated.

B Further statistics regarding termination payments

Table B.1: Extract from the estimated costs of the principal tax expenditure and structural reliefs

	2012-13	2013-14
Exemption of first £30,000 of payment on termination of employment	£900m	£800m

Note: These figures are particularly tentative, rounded and subject to a wide margin of error.

Source: HMRC Estimated costs of the principal tax expenditure and structural reliefs
http://www.hmrc.gov.uk/statistics/expenditures/table1-5.pdf

Table B.2: Number of redundancy payments in FRS data, split by value of payment

Amount of redundancy payment (nominal)	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
<£10,000	233,337	202,746	268,866	377,389	257,083	243,945
£10,000-<£20,000	29,166	39,833	29,371	60,248	43,961	70,876
£20,000-<£30,000	18,535	22,908	29,009	33,174	22,569	40,636
£30,000-<£40,000	24,599	15,995	14,774	26,430	14,654	14,101
£40,000-<£50,000	5,159	6,861	6,520	8,954	12,138	11,488
£50,000-<£75,000	18,598	11,672	3,208	13,565	12,475	9,156
£75,000-<£100,000	7,395	2,053	3,441	6,346	866	7,619
£100,000+	4,774	2,018	0	8,857	3,352	3,548
Total	**341,563**	**304,086**	**355,189**	**534,963**	**367,098**	**401,369**
Average payment	**£15,276**	**£12,674**	**£9,332**	**£11,935**	**£11,058**	**£13,386**

Note: These figures are particularly tentative and subject to a wide margin of error.

Source: HMRC analysis of the Family Resource Survey (FRS) data.

C International comparisons of accommodation benefits

Analysis has been provided by HM Treasury and OTS officers regarding the tax treatment of accommodation benefits provided by an employer to an employee internationally, with the purpose of comparing this to the UK tax treatment of accommodation benefits. Resources used were primarily government websites of the respective countries; typically the website of the Finance or Tax Ministry provided the information required.

(Note: this research has been provided for illustrative purposes and should not be relied upon by individuals or organisations for their tax purposes.)

CASE STUDY 1: Australia

Background

Fringe benefits provided by the employer, in kind or otherwise, are generally not assessable on the employee. The employer is subject to a separate Fringe Benefits Tax (FBT) on the total amount of taxable fringe benefits paid to employees. Allowances paid by employers to compensate employees for the costs of living away from home are also subject to fringe benefits tax, but are out of the scope of this note.

Valuation of accommodation benefits

The taxable value of a housing fringe benefit is measured by reference to the market value of the right to occupy the unit of accommodation reduced by any 'recipients rent' which in effect are rental payments.

Certain factors are disregarded in determining the market value of the right to occupy a unit of accommodation, namely:

- Any rights of the occupant to have expenses associated with the occupancy paid for by the employer
- Any onerous conditions of the occupancy relating to the occupant's employment.

This means, in effect, that the right to occupy the unit of accommodation is valued according to what it would command for rent in an open market situation, without taking into account any special employment conditions or associated expenses of the occupant that might be paid by another person.

In normal valuation practice, the market rental is what a willing but not anxious person would be prepared to pay the owner to occupy the particular property in its existing condition if it were placed on the open market for rent. Ordinarily, market rental is ascertained by comparing it with similar properties, on the basis that the best evidence of the market rental value of a property is found by examining rents obtained for comparable properties in the locality.

As an alternative to establishing the market rental value every year, an employer may base the taxable value for the second and subsequent years on the first year's market rental value and applying an inflation factor. This may be done for a maximum of nine consecutive years.

Exemption

Exempt accommodation benefits are:

- *Accommodation provided by a religious or non-profit organisations*: Benefits provided by registered religious institutions to a religious practitioner are exempt benefits if the benefits are provided principally because of the practitioner's pastoral duties or any other duties relating to the practice, study, teaching or propagation of religious beliefs.
- An exemption from FBT does not apply to all non-profit organisations, only those whose principal objects are: the relief of poverty, sickness, suffering, distress, misfortune, destitution or helplessness; or promoting the prevention or control of diseases in human beings, and whose activities are carried on without the purpose of private gain for particular people. Such organisations must be registered with a regulator to qualify for the FBT concession.
- *Accommodation that is not the normal residence of the employee*: Fringe Benefit Tax does not apply where the employee is living somewhere that is not their normal residence as part of their work-related duties, or where an employee is travelling as part of their work-related duties.
- *Accommodation in a remote area*: The rules to decide whether an area is remote depend on distance to workplace and whether there are any stretches of water in between the accommodation and the workplace.

FBT reductions

Reductions of FBT are available for:

- *Accommodation in a caravan, mobile home, hotel, motel, hostel or guesthouse where the person providing the benefit is carrying on a business of providing such accommodation to the public*: If the accommodation is provided to an employee of the hotel, caravan park, etc, and is identical or similar to that provided to paying guests, the taxable value is 75% (rather than 100%) of the market rental value, less the amount of any rental payments.
- *Temporary accommodation provided for relocation*: This concession reduces the taxable value of fringe benefits arising from providing temporary accommodation to an employee who changes their usual place of residence during employment, or to start employment.

Source information

A comprehensive and easy-to-find guide to the rules surrounding the Fringe Benefits Tax can be found on the Australian Taxation Office's website. The section relating specifically to housing accommodation can be found by looking at the 'employer's guide'.

CASE STUDY 2: France

Background

Benefits in kind are defined as the passing of a benefit, either free of charge or at an undervalue. Benefits in kind are treated as taxable income and must be added to the taxpayer's salary, thus the employee pays both income tax and Social Security Contributions on the value of accommodation benefits included in taxable income.

Valuation of accommodation benefits

If the employer covers all of the value of the accommodation benefit, then this is taxable in full. If this is to some extent covered by the employee (the employer provides it at an undervalue), than the taxable amount is the difference between the value and the amount covered by the employee. The taxable amount is also increased by any utility bills paid for by the employer.

An employer may opt to value accommodation benefits in two ways: notionally, based on the size of the accommodation and the taxpayer's remuneration, according to a table published annually or, on the rental value determined by the tax authorities for the assessment of the dwelling tax relating to the accommodation itself:

- *Notional method of valuation*: The monthly value of accommodation using this method is as shown below:

Monthly remuneration	Notional value of a studio (€)	Notional value per room for larger accommodation (€)
Less than €1,543.00	65.80	35.10
€1,543.00 – €1,851.60	76.90	49.40
€1,851.60 – €2,160.20	87.80	65.80
€2,160.20 – €2,777.40	98.60	82.20
€2,777.40 – €3,394.60	120.70	104.10
€3,394.60 – €4,011.80	142.50	126.10
€4,011.80 – €4,629.00	164.50	153.40
Above €4,629.00	186.50	175.50

- *Rental value determined for the dwelling tax*: This is the cadastral value of the house, multiplied by certain coefficients, depending on the locality in which the house is in. The cadastre is not often updated; rather the values are increased by an inflation coefficient, which it is assumed all house prices have gone up by.

Exemption and reductions

The following exemptions from taxable income and reductions of the taxable value apply.

- *Lodgings necessary for carrying out the employment*: When the employer-provided accommodation is necessary in order for the employee to properly carry out their employment duties (such as a groundskeeper), the value of the accommodation added to taxable income is reduced by 30%.
- *Lodgings that are of private benefit but also have a professional use*: In this case the employer may exclude the rooms that are reserved for professional use (to carry out the employment agreed between employer and employee) when determining the value of the house.

CASE STUDY 3: Italy

Background

Income from employment consists not only of salaries but all compensation, whether in cash or in kind, received during the tax year, including any compensation received as profit sharing with reference to an employment relationship, reimbursement of expenses relating to the production of income and gratuitous payments.

Valuation

Benefits in kind, including those received by family members of the employee, and the right to obtain them from third parties are deemed to constitute income equal to their 'normal value'. Benefits in kind are taxable in the hands of the employee if their amount exceeds, in the tax year, €258.23.

Employer-provided accommodation is subject to its own set of rules with regards to determining the 'normal value'. This is defined by the cadastral value of the accommodation (notional rental value), increased by all the inherent costs related to occupying the accommodation (such as utilities) paid by the employer rather than the employee. This is then reduced by any amount paid by the employee to the employer with relation to the accommodation to arrive at the taxable value or 'normal value'. The cadastral value of property is the value used for local property taxes and is determined by the local authority responsible for setting these taxes.

In the case of properties not registered in the cadastre (most likely overseas accommodation), the 'normal value' is determined by the accommodation's rental value and reduced by any amount paid by the employee.

Exemptions and reductions

The following preferential treatment applies:

- *Employer-provided accommodation in which the employee is obliged to dwell*: There is a different treatment of accommodation provided by the employer in which the employee is obliged to dwell as part of the work contract. This is most likely to be because living in this accommodation is necessary in order to carry out the employment, for example for a groundskeeper. In this case once the 'normal value' has been calculated, it is reduced by 70%.
- *Employer-provided accommodation in the case of a relocation away from the normal place of work*: This is entirely excluded from the employee's taxable income.
- *Fringe benefits provided in the employer's interest*: Although no specific reference is made to the exclusion of accommodation provided in the normal running of the business, such as for an employee business trip, there is a provision that fringe benefits provided in the employer's interest are non-taxable. It should be expected that accommodation provided by employers that is provided in the context of generating revenue (and is essentially an expense), such as in the case of an employee business trip, would be excluded from an employee's income under this rule.

CASE STUDY 4: New Zealand

Background

Accommodation benefits provided by employers were considered employment income and subject to Income Tax before the introduction of a Fringe Benefits Tax in New Zealand and as a result are outside of the scope of the Fringe Benefits Tax and subject to an individual set of tax rules. There have been recent efforts at reforming the New Zealand rules surrounding the taxation of accommodation benefits in order to provide more clarity, with the introduction of a bill to this effect in November 2013. The latest development is that the bill passed its second reading on 27 May 2014; more info can be found here.

Rules on the taxation of accommodation benefits are not easy to find, there is no

comprehensive guide and once they have been found are muddled and open to interpretation.

Valuation

Legislation provides that the value of accommodation benefits to be added to the employee's taxable income is the market value. In the case where the accommodation is used for entirely private purposes, the market value is determined to be the rental value of the house. In the case of a house that is owned by the employer and the employee pays no or low-value rent, the taxable amount is the deemed rental value of the house, reduced by any rent payments the employee makes to the employer.

Where there is also a work element, and not just a private benefit, to the accommodation provided for the employee by the employer, determining the taxable value (the value to be included in the employee's income) becomes more complicated and this is where the New Zealand system lacks clarity. This is because, although the legislation provides for the market value to be the taxable element of accommodation, the policy rationale is that accommodation should be taxed to the extent it constitutes a private benefit.

Valuation – areas of uncertainty

The most obvious example of this is the case where an employee has been temporarily relocated to another city (away from their normal place of work), such as an out-of-town secondment. Other situations are also considered.

- Temporary relocation
- There is no provision for this in the Income Tax Act, but until recently the general consensus was that accommodation provided in this context should not be taxed. This is because it is provided in the context of carrying out one's work and there is no net private benefit, especially if the individual is maintaining their previous accommodation/home. Commissioner's Statement CS 12/01 of Dec 2011 overturned this by outlining the Commissioner's view that the law does not provide for a 'net benefit' approach and as such, accommodation benefits should be taxed, regardless of whether they are provided as a temporary relocation measure. Taxpayers were encouraged to voluntarily disclose any previous interpretations of the law that weren't in line with the Commissioner's view.
- Accommodation necessary for proper carrying out of employment
- Despite the position that only the 'private benefit' element of employer-provided accommodation should be taxed, the taxable element of accommodation provided as a necessity to carry out employment (such as for a groundskeeper) is still taxed at the fair market value. This is believed to not differ too much from private benefit to the employee.

Current exemptions

The following are exempt from income tax:

- *Work-related relocation payments*: Any relocation payments made as a result of relocation necessary for the employee's work and where the employee's current residence is outside a reasonable distance from the workplace are not taxable. Such a situation is if the employee is: taking up new employment with a new employer, taking up new duties in a different location with the same employer or continuing their current position but at a new location.
- *Accommodation provided as part of work travel*: Where accommodation provided is necessary as part of work-related travelling, generally referred to as 'overnight

accommodation', this amount is not included in taxable income.

- *Accommodation provided by religious societies*: Accommodation provided by religious societies to members is exempt from tax, so long as it is the nature of the religious society that they do not pay for work and instead provide basic necessities, such as accommodation.

Reform bill

To be introduced if the bill referred to in the background section receives assent:

- Employer-provided accommodation where the employee is temporarily required to work away from their normal place of work would be tax-exempt for up to two years.
- Accommodation benefits for employees who work at more than one workplace on an on-going basis would be exempt with no upper time limit.
- Introduction of an exemption for church-provided accommodation for ministers of religion, as well as army-provided accommodation and other exemptions.
- The value of overseas accommodation provided will be capped at the value of accommodation that an employee could expect to be provided in New Zealand, rather than be strictly equal to the market value.

Source:
The latest rules to do with the taxation of accommodation benefits were determined by using this proposal for changes to the taxation of accommodation benefits, detailing the situation in 2012 and the Inland Revenue Department's proposals for change and this feed of changes made since 2012. Also useful is KPMG's response to a consultation by the Inland Revenue Department on accommodation benefits.
This guide on the fringe benefit tax in New Zealand (i.e. the tax treatment of non-accommodation benefits in kind) may also be of interest.

CASE STUDY 5: Ireland

If employer-owned accommodation is provided to the employee, the value of the taxable benefit is the aggregate of any expense (other than the cost of acquisition) incurred by the employer in connection with the provision of the accommodation and the annual value of its use.

The annual value of its use is the annual rent which the employer might reasonably expect to obtain. A general rule of thumb for calculating this amount is 8% of the current market value of the property. However, where a vouched lower figure is available, e.g. an auctioneer's estimate, this figure may be used.

Unless the employee is a director, a taxable benefit will not arise if he or she is required by the terms of his or her employment to live in the accommodation provided to properly perform his or her duties ('better performance test'), and either:

- the accommodation is provided in accordance with a practice which, since before 30 July 1948, has commonly prevailed in trades of the class in question as respects employees of the class in question,
- or it is necessary, in the particular class of trade, for employees of the class in question to live on the premises.

The 'better performance test' is met where:

- the employee is required to be on call outside normal hours, and
- the employee is in fact frequently called out, and

- the accommodation is provided so that the employee may have quick access to the place of employment.

(e.g. Night care staff in residential or respite centres, or governors and chaplains in prisons.)

Where accommodation is rented, at a market rent, by an employer for an employee, the taxable benefit is the actual amount of rent paid less any amount the employee makes good.

Where the employer meets any of the costs associated with the provision of living accommodation, e.g. cost of light or heat, a taxable benefit will arise on the amount met by the employer and not made good by the employee.

Source: Irish Tax and Customs
Webpage: http://www.revenue.ie/en/tax/it/leaflets/benefit-in-kind/subsidised-accom.html

CASE STUDY 6: Canada

Generally, if an employer provides an employee with a house, apartment, or similar accommodation rent-free or for less than the fair market value, there is a taxable employee benefit. Although one obvious exception is for members of a religious order that might be entitled to claim a deduction.

The overall benefit is usually calculated as (the best estimate of) the fair market value for the same type of accommodation, minus any rent the employee paid, plus any reimbursement for utilities (such as telephone, hydro, natural gas, water, cable or internet).

The use of a 'fair market value' depends on whether the accommodation is in a 'prescribed zone' (specific cities and towns with developed rental markets). If it is, the fair market value can be used. If not, allowable ceiling amounts are used to help determine the value of the housing benefit.

The Canada Revenue Agency differentiates free or subsidised board and lodging from a house or apartment. However, the benefit is essentially calculated in the same way (fair market value less employee contribution). Under the rules of board and lodging, there are a number of exceptions/ reliefs, for instance, if the employee works at a special work site or a remote location. These phrases have specific definitions, for instance, a remote work location means:

- The employee could not reasonably be expected to set up and maintain a self-contained domestic establishment because of the remoteness of the location and the distance from any established community.
- The employer did not provide a self-contained domestic establishment for the employee.
- The reasonable allowances were for a period of at least 36 hours when: the employee had to be away from his or her principal place of residence because of his or her duties; or the employee had to be at the remote work location.

Source: Canada Revenue Agency
Webpage (housing benefits): http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/brd/hsng/menu-eng.html
Webpage (board and lodging): http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/bc-eng.html

CASE STUDY 7: United States of America

Certain types of lodging can be excluded from income. These exclusions are detailed below.

Employer provided

Employer provided lodging for the employee and their family.

But only if it is provided on the business premises of your employer, and provided for the convenience of your employer, and is a condition of your employment (i.e. you must accept it in order to be able to properly perform your duties).

Academic institutions

'Faculty lodging', that is, if you are an employee of an educational institution or an academic health centre and you are provided with lodging that does not meet the conditions above. However, the lodging must be qualified campus lodging, and you must pay an adequate rent.

Qualified campus lodging is lodging provided to you, your spouse, or one of your dependents, for use as a home, but it must be located on or near a campus of the educational institution or academic health centre.

'Adequate rent' is at least equal to the lesser of 5 per cent of the appraised value of the lodging, or the average of rentals paid by individuals (other than employees or students) for comparable lodging held for rent by the educational institution. If the amount you pay is less than the lesser of these amounts, you must include the difference in your income.

The lodging must be appraised by an independent appraiser and the appraisal must be reviewed on an annual basis.

Ministers of religion

Ministers of religion do not include as part of income the rental value of a home (including utilities) or a designated housing allowance provided as part of their pay. However, the allowance may not be excluded to the extent it exceeds reasonable compensation for services.

The home or allowance must be provided as compensation for services as an ordained, licensed, or commissioned minister (i.e. not just anyone).[1]

[1] http://www.irs.gov

D International comparisons of termination payments

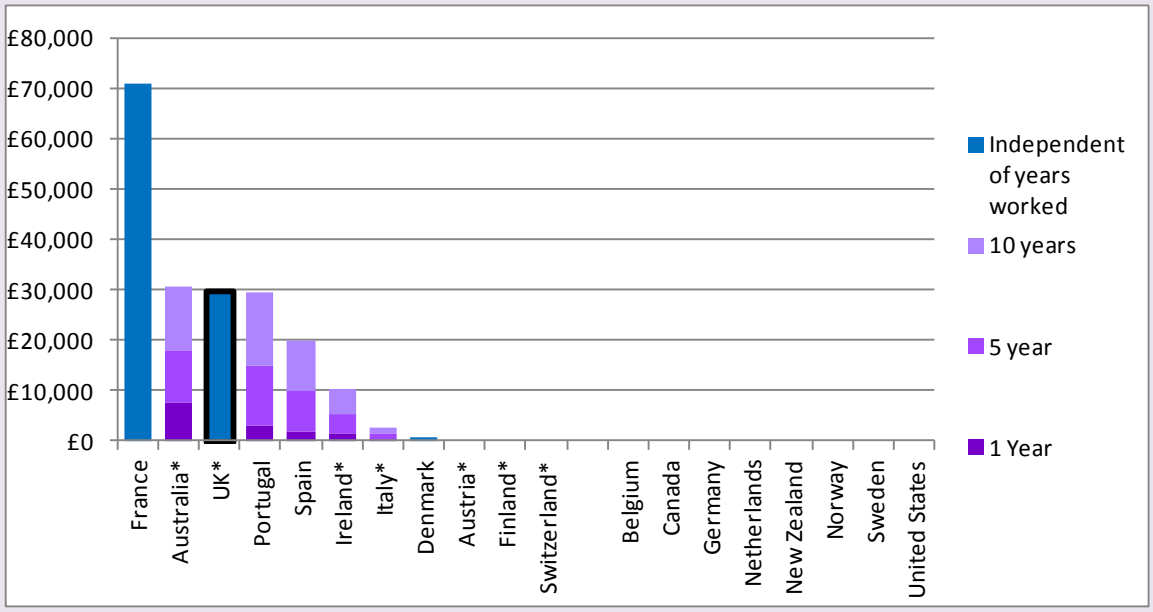
The notes below were kindly compiled for the OTS by HM Treasury. The intention was to assess how the UK tax treatment of termination payments compares internationally. A selection of advanced economies was chosen for analysis. These include the G7 and EU and OECD members whose economies are at similar levels of development as the UK's. Countries included were: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Korea, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland and the United States.

(Note: this research has been provided for illustrative purposes and should not be relied upon by individuals or organisations for their tax purposes.)

Box D.1: Exemption amounts

There was an even split (11 vs. 11) between the countries that do and don't offer some form of exemption from income tax for termination payments; however, of those that didn't offer an exemption, some offered another form of preferential tax treatment for such payments. From Chart D.1 below, of the countries that do offer exemptions, the UK has the second highest exemption that is independent of the years worked by the individual at the company with which the employment contract is being terminated. For a hypothetical employee who has been working at a company for 10 years before the termination of their employment, the UK has the third largest exemption amount. Naturally due to complexities in the rules surrounding the taxation of termination payments, which vary from country to country, some qualifiers are required.

Chart D.1: Exemption amount accorded to the severance/redundancy pay of a worker who earned £35,548 (UK average wage) over the past twelve months



Exemption amounts (continued)

First, Japan, Korea and Norway are not included in the graph, as the calculation of the exemption is to some extent determined by the size of the severance/redundancy payment. Without any knowledge of the typical size of redundancy/severance pay in these countries or the statutory amount of these payments, a meaningful comparison cannot be drawn. The tax systems in these countries are however very generous and are explored later in the note.

Moreover, a number of assumptions were made in order to allow for meaningful comparison. These were :

- It was assumed that the individual whose contract had been ended had earned the *UK* average wage of £35,548[1] in the twelve months before the termination of the contract. This was to allow for countries where the exemption amount depends on salary earned prior to termination.
- The ending of the employment contract was not as a result of misconduct by the employee. This is relevant because in some countries only *statutory* redundancy/severance pay is exempt from tax and the statutory redundancy/severance pay can in some cases be determined by the manner in which the employment contract ended.
- If relevant, the redundancy/severance pay received is assumed to be the statutory amount.
- Any other favourable treatment of termination payments has not been taken into account for the purposes of the graph and the salient points are discussed later in the note.

From the graph it can be seen that if the exemption amount were to be raised to around the £75,000 level, as suggested by some stakeholders in the OTS interim report[2], the UK would have the highest exemption amount of the developed economies picked for this analysis. It is worth noting however, that this would not make its tax treatment of severance pay more generous than France's, as France exempts *at least* twice the amount of the employee's salary – effectively taking severance payments out of tax altogether.

[1] *Taxing Wages* 2014, OECD, 2014

[2] *Review of employee benefits and expenses: interim report*, OTS, 2013

Box D.2: Exemption amount – years worked

Of the 11 countries that offer some form of tax exemption to a portion of termination payments, 8 of them link the amount of the exemption to the years worked at the company with which the employment contract is ending (Japan and Korea's exemptions depend on years worked, Norway's does not). This has the effect that if an individual reaching the termination of their employment has worked with their current company for less than 10 years, the UK has the second most generous exemption amount of the countries included in Chart 1. As the amount of time worked before termination increases, the UK's tax system becomes relatively less generous compared to the 8 countries whose exemptions depend upon the years worked. For example, after 11 years worked the UK's system would be less generous than Portugal's and so on as the amount of time worked increases.

Box D.3: Exemption amount – previous salary

France, Portugal and Spain all provide for an exemption that is dependent upon the salary previously earned by the individual terminating their employment contract.

- *France.* For France this is part of a system where the exemption is equal to the largest of these three amounts: twice the remuneration in the calendar year preceding the termination, half of the severance pay and the minimum severance pay set by the relevant collective labour agreement or law. There is an overall cap of €225,288.
- *Portugal.* The exemption is determined by a formula taking into account the average salary in the twelve months previous to termination and the number of years worked.
- *Spain*. Statutory severance pay is exempt. Statutory severance pay is calculated using a formula that takes into account the average salary in the twelve months previous to termination and the number or years worked.

Box D.4: Exemption amount – size of termination payment

The below countries offer a tax exemption that is to some degree determined by the size of the termination payment.

- *Japan and Korea.* Both offer an exemption from taxable income for a certain percentage (Korea 40%, Japan 50%) of the termination payment, so the size of the exemption depends on the size of the termination payment. Both countries also offer further deductions from taxable income based on years worked.
- *Norway.* The exemption is equal to 150% of the severance/redundancy pay as defined in a collective labour agreement.
- *Spain.* The full amount of statutory redundancy/severance pay is excluded from taxation. Any payment in excess of this benefits from a 40% reduction, provided that the individual has worked at the company for more than two years. The maximum amount that can benefit from the 40% reduction is €300,000 and the reduction is phased out for payments of €700,000 or more.

Box D.5: Other preferential treatments of termination payments

Of the countries surveyed Australia, Austria, Finland, Italy, Japan, Korea, Switzerland and the UK have some form of preferential treatment of severance pay other than a tax exemption; Denmark, France, Norway, Portugal and Spain don't offer some form of preferential treatment in addition to an exemption from tax.

- *Reduced rates of tax.* Many of these countries offer lower rates of tax than those applicable to personal income. Australia taxes termination payments at the marginal rate or 31.5%, whichever is lower; Austria offers much lower rates that vary depending on certain conditions;
- *Taxed separately to other income.* Japan, Korea and Switzerland all allow individuals to tax termination payments separately to their other personal income, resulting in lower tax rates than otherwise, provided that the taxpayer has some other form of personal income.
- *Income spreading.* Finland allows individuals to opt to divide the payment received by the amount of years worked (max. 5 years) and then apply the marginal rate that applies to this portion to the whole of the payment, resulting in a lower rate of tax; Italy operates a somewhat similar system, but multiplies the payment by 12 and then divides by years worked, calculates the income tax due on this portion and multiplies this amount by the years worked – if the individual opts to do so.
- *Exemption from NICs.* The UK offers an exemption from NICs on all payments that are eligible for the £30,000 exemption, regardless of the size of the payment.

Box D.6: Countries with no preferential treatment for termination payments

As can be seen in Chart D.1, there are a group of countries that offer no form of preferential tax treatment for termination payments; such payments are viewed as taxable employment income. These countries are: Belgium, Canada, Germany, Ireland, Korea, the Netherlands, Sweden and the United Kingdom.

E List of stakeholder meetings

During the early stages of the employee benefits and expenses project we met with a wide range of stakeholders, spanning representative bodies such as the CBI, large companies such as BT, and smaller organisations as well. A full list of the meetings held can be found in Annex B of our interim report.

Since the earlier stage, we have built on a lot of the points raised, and have scheduled more focused meetings about accommodation benefits and termination payments. In addition, we have received many relevant comments during our evidence gathering for our Competitiveness project. The stakeholders we have spoken to in formal meetings over Accommodation benefits and Termination payments include:

Baker & McKenzie

British Holiday & Home Parks Association

British Hospitality Association

British Universities Finance Directors Group

Cameron McKenna

Chartered Institute of Taxation

Churches' Legislation Advisory Service

Country Land and Business Association

Crowe Clark Whitehill LLP

HM Revenue and Customs

HM Treasury

Independent schools

KPMG

National Farmers Union

National Trust

Smith & Williamson LLP

Travers Smith

Valuation Office Agency

F HMRC update on the 'quick wins' published in the interim report

This section provides an update from HMRC of the progress made on the 'quick wins' recommended in our interim report on employee benefits and expenses, which comprised 43 changes which if adopted could benefit both businesses and individuals in the short term.

HMRC officials have been working to deliver these changes and have provided a progress report – detailed below.

By the end of January 2014 HMRC had already implemented 13 of the 'quick wins' recommended by the OTS these included:		
Quick win 7	Allow reimbursement of car fuel where the employee contributes by 6 July	Achieved
Quick win 14	HMRC should give better guidance on what qualifies for subsistence expenses	Achieved
Quick win 23	Improve HMRC guidance regarding the operation of the OT tax code in relation to termination payments, and the timing for issuing the P45	Achieved
Quick win 29	Introduce facility to re-submit forms P11D and P11D(b) online	Achieved
Quick win 32	HMRC to improve guidance on allowable expenses	Achieved
Quick win 34	Improve web-site guidance and cross referencing, for example keep the 'What's New' pages up to date	Achieved
Quick win 35	HMRC should publish a list of standard items and conditions that will always qualify for dispensations*	Achieved
Quick win 37.	HMRC should make it clear that they allow PSAs to be made for overseas employees and non-doms	Achieved
Quick win 38	The online dispensation process should be publicised and made available to all employers*	Achieved
Quick win 39	Allow adjustments in relation to AMAP reimbursements to be submitted online	Achieved
Quick win 40	HMRC to improve guidance and awareness of dispensations and PSAs*	Achieved
Quick win 42	HMRC should reintroduce voluntary use of form P46(Car) when a car is replaced	Achieved
Quick win 43	Providing new employers with a link to the relevant sections of the HMRC website when they first register	Achieved
* Further changes may take place to these recommendations as HMRC are currently consulting on the introduction of an allowance for paid or reimbursed expenses which may mean that Dispensations are no longer required.		

Since January 2014 HMRC has achieved a further 'quick win' this had originally been scheduled for implementation by April 2017 but has now been completed - details of this achievement are below.

Quick win 25	Employers should be able to sort out straightforward employee tax issues with HMRC if the employee gives consent.	This has been achieved and employers are now able to sort out straightforward tax issues that involve no disclosure of personal information about an employee to a third party.

HMRC now have another 10 'quick wins' under consideration with a view to implementing as many as possible by the end of the current parliament in May 2015. The current position on each of these is shown in the final column below.		
Quick win 2	HMRC to review published list of employments where it is "customary" to get accommodation	HMRC are awaiting the findings of the OTS report into Living Accommodation and will respond to this recommendation once that report is published at the end of July 2014
Quick win 11	HMRC should publish a list of benefits they consider to be trivial, presumably with limits on the amounts	HMRC are consulting on the introduction of a trivial benefits exemption with a view to legislating in Finance Bill 2015.
Quick win 16	HMRC should commit to revising and updating the booklet 490 to fit better with modern working patterns	HMRC are beginning work on reviewing the content of booklet 490 and are scheduled to have this completed by early next year and published before May 2015.
Quick win 17	HMRC to publish guidance on temporary workplace rules for projects carried out in phases	Revised guidance on this will be published in the Employment Income Manual by the end of September 2014.
Quick win 19	Why do relocation expenses need to be entered in three different places on the form P11D? Once is enough.	As part of HMRC's annual review of the Form P11D they will explore the possibility of grouping benefits in kind relating to qualifying and non-qualifying relocation expenses together.
Quick win 27	Improve communication between HMRC officers dealing with employer and employee	HMRC are still exploring ways of implementing this recommendation
Quick win 28	Improve guidance and design of Form P11D, for example state that you need a different form if the employee earns less than £8,500	HMRC are currently consulting on the abolition of the £8,500 threshold with a view to legislating in Finance Bill 2015. This will mean that the P9D return will be abolished with all Benefits in Kind and expenses being returned on one form (P11D).
Quick win 30	Add a box to the P11D to tick if the benefit is just for one year	HMRC are exploring how this request could be implemented which will require changes to both the P11D & processing IT systems.
Quick win 31	Allow voluntary notification of in-year changes to benefits	This is being taken forward as part of HMRC's digital agenda. Since April 2014 a number of employees have been able to notify when they begin to receive Company Car and Car Fuel benefit online, this is to be expanded to cover Company car changes and then extended to other types of Benefits in Kind and expenses.
Quick win 41	HMRC to improve layout and design of Form P87 for claiming expenses	HMRC is currently trialling an interactive version of form P87 which it is hoped will help customers avoid the most common errors that were made on this form in the past. The trial is

		available for customers to use on HMRC's website at http://www.hmrc.gov.uk/forms/p87form.htm which also allows customers to provide us with feedback on the form. HMRC continues to work on ways of making it as simple as possible for customers to receive the tax relief that they're due

The remaining 9 'quick wins' are part of a much longer piece of work. Where they can be achieved the intended completion date for these 'quick wins' is April 2017. These include:		
Quick win 1	HMRC to encourage voluntary pay-rolling of benefits, in place of reporting benefits on forms P11D*	HMRC are currently consulting on the introduction of voluntary 'payrolling' with a view to legislating in Finance Bill 2015.
Quick win 3	HMRC to allow home broadband costs to be subject to PSAs	The Government does not believe that widening the scope of PSAs in this way would be consistent with their purpose. However HMRC will consider the case for specific Benefits in Kind being permitted within a PSA provided that they meet the relevant statutory tests.
Quick win 6	Car fuel benefit should be based on what you put in your tank, not how you pay	HMRC will not be taking this recommendation forward at the present time as it would add administrative burden on employers and employees in monitoring the private use of company car fuel provided. However, when developing any policy for this area in the future, consideration will be made of this recommendation.
Quick win 12	Align tax and NICs treatment of mileage rates over 45p	HMRC have noted this recommendation and are considering the matter further.
Quick win 18	HMRC should stop treating London as one workplace regardless of travel time	HMRC will consider this 'quick win' further following the conclusion of the review of Travel & Subsistence to be published shortly.
Quick win 24	Allow a single return of continuing benefits given on termination where these are provided for a set period of up to two years	HMRC are continuing to impact this suggestion as this will require changes both to the P11D & processing IT systems,
Quick win 26	Introduce a process where tax codes with fixed expense allowances are reviewed when employments change	HMRC are currently considering options for ways of improving the administration of FREs.
Quick win 33	HMRC to allow all types of expenses claims to be made on one form, or online	This is being taken forward as part of HMRC's digital agenda.
Quick win 36	Allow dispensations to be made for a tax year by 6 July of the following year	HMRC are currently consulting on the introduction of a General Expense Allowance with a view to legislating in Finance Bill 2015. If introduced this will replace Dispensations.

It was decided that 10 of the 'quick wins' would be taken forward by other routes. These 'quick wins' included:		
Quick win 4	Allow car fleet operators to buy multi-year road fund licences	It Is for the OTS to refer this matter to the Driver Vehicle & Licensing Agency (DVLA).
Quick win 5	Exempt electricity for electric cars from the benefit rules	We do not think this would affect many people right now.
Quick win 8	Carry out a proper evaluation of the cycle schemes success and look for ways of streamlining its administration	The OTS believes the scheme is administratively burdensome, and that the main impact is giving bikes to people who would cycle anyway or don't use them much. Particular problems include the 50 per cent commuting requirement (seen as unenforceable), VAT calculations, transferring the bike at the end of the period, and the £1,000 limit. (note: further information about the OTS stance on this issue is provided at 3.23)
Quick win 9	Long Service Awards - Bring the minimum length of service down to 5 years	The OTS believes the exemption should be reformed to make it better fit today's working environment. This means a 10 year minimum (instead of 20 years), allowing vouchers to be given (up to a maximum amount), and abolishing the 10 year interval rule. (note: further information about the OTS stance on this issue is provided at 3.27)
Quick win 10	Long Service Awards - Allow the exemption to apply if there has been a previous award unless that was within 5 years	
Quick win 13	HMRC should not require retention of fuel VAT receipts for expense claims where only a mileage rate has been claimed	Quick win 13 is not achievable as the requirement to retain receipts comes out of an EU directive relating to the retention of receipts for VAT purposes.
Quick win 15	HMRC should reinstate the practice of having a 'friends and family' subsistence scale rate	This is more of a policy change than a simplification.
Quick win 20	Remove the 5 April requirement in s274 ITEPA: change it to 'within X months of commencing new duties'	No further comments.
Quick win 21	HMRC to review its policy on "auto PILONS"	The Office of Tax Simplification is currently undertaking a review of the rules surrounding Termination payments. The government will respond at Autumn Statement 2014.
Quick win 22	Simplify rules for overseas employees	The Office of Tax Simplification is currently undertaking a review of the rules surrounding Termination payments. The government will respond at Autumn Statement 2014.

Office of Tax Simplification contacts

This document can be found in full on our website at:
https://www.gov.uk/government/organisations/office-of-tax-simplification

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