

19 October 2016

## Consultation on Salary Sacrifice (SS) for the Provision of Benefits in Kind (BiK)

### Response by the Office of Tax Simplification

#### 1. Introduction and summary

- 1.1 The focus of the OTS is on simplification of the tax system. That encompasses two broad arms: technical simplification (simplifying the legislation and rules) and administrative simplifications (making the tax system easier to deal with). Our response to the current consultation concerns itself with issues of simplicity and complexity. Therefore we have not answered each question in turn but provided a short commentary.
- 1.2 It seems that the underlying principle behind this consultation is a policy that everyone should pay the same amount of income tax (IT) and NICs on the same remuneration package. From the OTS's point of view, that is a simple result, not least because it will be readily understood. Historically, BiKs have not generally been charged to NICs, though the employer NIC charge via Class 1A is now well established. In the OTS's report on the Closer Alignment of IT and NICs, published in March<sup>1</sup>, we put forward a seven-stage programme for reform which included bringing BiKs fully into the NIC ambit. Although that is on the surface an increase in taxation on those in receipt of benefits we found strong support from those we spoke to for such a move.<sup>2</sup>
- 1.3 However, this consultation tackles only one aspect of the rules around BiKs, where HMRC believes that the rules significantly undervalue the BiKs. From a simplification point of view we would suggest it would instead be better to reform the whole area in one go. That said, we acknowledge that our reform programme around IT/NICs is a long term project and HMRC must be free to tackle problems with the system in the meantime.
- 1.4 The policy objective around the current consultation as we understand it is twofold:
  - a) To address the perceived unfairness of two individuals receiving the same value of remuneration but paying different levels of tax depending on the extent to which benefits are provided under a salary sacrifice arrangement; and

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<sup>1</sup> <https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions>

<sup>2</sup> As we noted, the position of our wide variety of stakeholders seems to have changed over the last three years. Most now see the exclusion of BiKs from employee NICs as an anomaly that gives such recipients an unfair advantage compared with those who simply receive cash pay and fund their own benefits.

- b) To reduce loss of tax to the Exchequer by ensuring that employers that use BiKs (excluding those BiKs outlined in the consultation document) in place of some amount of monetary remuneration, pay the same amount of tax as they would have done had the employee instead received the cash equivalent.

## 2. The Office of Tax Simplification

- 2.1 The OTS is an independent office of HM Treasury, established in 2010 to provide independent advice to Ministers on ways of simplifying the UK tax system. In developing our recommendations we carry out extensive evidence gathering from all those involved with the tax system – businesses large and small, individuals, representative bodies, advisers and HMRC. Our recommendations cover both technical and administrative aspects of the tax system.
- 2.2 The OTS is now established on a statutory basis by FA 2016 with an expanded remit. As well as researching specific areas of the tax system as requested by Ministers, our new remit now puts greater onus on the OTS to actively seek areas of complication and responding accordingly. And it is in that context that we comment on this consultation.

## 3 Increased complexity

- 3.1 It is important to appreciate that there are various ways that an employee's remuneration package can be impacted:
- adjustment of hours, mainly to part time or flexitime but extra holiday can also be categorised here
  - 'simple' salary sacrifice, where an existing salary is varied to give the employee a benefit (the first example in para 2.1 of the condoc)
  - the flexible package (sometimes referred to as a cafeteria plan) where the employee can select how they are to be paid (the example in para 2.2 is similar)
- 3.2 We do have some concerns that identifying the cash forgone in the third situation may cause some complexities in practice.
- 3.3 We would also note in passing and in response to question 1 that the adjustments of hours should not lead to a benefit charge (which para 3.7 seems to recognise).
- 3.4 The current consultation seeks to tackle the situation where a salary sacrifice takes place and
- the benefit obtained is normally exempted from tax – it is proposed to remove this exemption except in defined cases
  - the amount of the benefit to be taxed will be the higher of the salary sacrificed and the cash equivalent of the benefit in the benefits code
- 3.5 The list of benefits that will be excluded from this new charge is set out at para 3.3; the following para notes that the Government has considered allowing further health-related benefits to similarly qualify but has ruled this out. On simplification grounds we would argue

that there should be a clear policy rationale here that people can understand, so we find it odd that health screening, for example, would not seem to qualify.

- 3.6 In response to questions 6 & 7, we have always argued that the effectiveness of exemptions and extra reliefs – which add to the complexity of the tax system – need to be evaluated and justified as effective and value for money.
- 3.7 We note that while it addresses fairness in one instance, the design of the new policy introduces an unfairness and complication by taxing the value of BiKs when salary is sacrificed differently to when the same BiKs are offered but salary is not sacrificed. For example employee A, who receives a fixed salary of £29,000 with additional BiKs valued at £1,000 may pay less tax than employee B, who receives a starting salary of £30,000 but sacrifices £1,000 of cash for BiKs valued at £1,000. Employee A’s BiKs will be valued under rules that generally undervalue the asset and may indeed exempt the asset from charge but employee B’s BiKs will be valued at the cash sacrificed.
- 3.8 Furthermore those captured by the new tax arrangements will still be subject to class 1A NICs not class 1 NICs on BiKs. There are now three possible effective rates of taxation for those receiving the same income. To add a further complication, it is easily possible for an employee to have some salary sacrificed BiKs and some non-salary sacrificed BiKs, subjecting them to multiple effective tax rates (Table 1).

**Table 1**

Existing tiers	<b>Tier 1</b>	Paying income tax (IT), employee NICs and employer NICs on everything (where total remuneration is in cash);
	<b>Tier 2</b>	Paying IT, employee NICs and employer NICs on just the part of the remuneration package, and only IT and employer NICs at a lower effective rate on the BiKs portion (as will continue to be the case where salary is not sacrificed). <sup>3</sup>
New tier	<b>Tier 3</b>	A new tier of paying IT, employee NICs and employer NICs on the cash part of the remuneration package, and income tax and employer NICs but not employee NICs on the BiKs portion (where salary is sacrificed for BiKs).

- 3.9 It is only in instances where an employee falls fully into tier 1 or the newly introduced tier 3 that the policy will meet its objectives. Those in tier 2 will continue to pay a rate of IT and NICs that HMRC believes undervalues the true cost of the BiKs.

#### **4 Practicalities**

- 4.1 Returning to the point at para 2.2 above, there could be an issue with policing this policy. As drafted, employers can ask the employee to choose the BiKs that they want at the start of the employment or period. The employer can then draw out a new contract setting the fixed salary at the original salary less BiKs cost and setting out the BiKs on top. This will allow employers to continue to pay a rate of IT/employer NICs based on the lower HMRC BiKs valuation rather than the salary being sacrificed, i.e. move from tier 3 to tier 2.

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<sup>3</sup> HMRC assumes that their rules significantly undervalue BiKs.

- 4.2 We wonder how practical it is for HMRC to police this behaviour without imposing complex new requirements for certification.
- 4.3 If this policy cannot be effectively policed, perhaps the simplest approach is to adjust the formula currently used to establish the value of BiKs – or of course to review the whole area of taxation of BiKs to see if it is possible to get to a simpler system. We would refer to the OTS's various reports on Employee Benefits and Expenses in this regard and our recommendations there for a fundamental review.
- 4.4 If this change is to go ahead, we think there will be a need for a reasonable transition period (question 8 refers). Partly that will be to allow those already in salary sacrifice arrangements to adjust to the change but more importantly there will be a need to develop/adjust payroll programmes. That may extend to the interface with voluntary payrolling of benefits. We assume HMRC will be discussing the necessary timescale with payroll software providers.

The Office of Tax Simplification

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