Office of
Tax Simplification

Employee Benefits and Expenses – Terms of Reference

Employee taxation needs to cope with ever-changing ways of remunerating staff. The simple concept that all employee reward should be subject to taxation has been subjected to many exceptions and difficulties. The rules for income tax and national insurance (NIC) are often very different, stemming from the fact that NIC law did not charge 'benefits' to NICs.

The OTS project

It is therefore proposed that the OTS carry out a review of the rules surrounding employee expenses and benefits. The overall aim will be to look for opportunities for simplification, consistent with the OTS's rationale, but this will be an opportunity to review the way working patterns have changed since the various tax rules were developed and questions whether the rules are still appropriate and efficient.

We envisage there being three stages to the work:

a. initial scoping, leading to a report on problem areas in practice;
b. study of a significant area, for example travel and subsistence expenses, with a view to developing recommendations for simplification; and
c. study of further areas of the benefits code, informed by the work to date but which might be areas such as accommodation or car benefits, to develop proposals for modernisation/simplification.

The review would also look at what, if any, problems exist in practice with termination payments and whether simplification is needed.

Background

The OTS review of tax reliefs identified a number of complexities around the taxation of employee benefits, including different rules for tax and NICs, the £8,500 threshold, and some small benefits that are exempt from tax. The OTS review of small business taxation identified the process for reporting benefits on P11D forms as particularly burdensome for employers. OTS meetings with tax agents and HMRC frontline staff identified some complexities in the rules for benefits, as well as practical issues around some benefits and redundancy payments.

Some non-cash benefits are taxed on all employees but there is a major dividing line for employees earning more than £8,500 who receive non-cash benefits from their employment. They are charged to income tax under the tax rules for employee benefits in Part 3, ITEPA 2003. The core of these rules date from the 1970s.

NICs are adapted by way of the Class 1A national insurance charge which applies to employee benefits but is chargeable only on the employer, not the employee.

Employees can claim a deduction for general expenses against their employment income if they are incurred wholly, exclusively and necessarily in the performance of their duties; or for travel and subsistence expenses if they are necessarily incurred on travel in the performance of their duties or for attendance at a temporary workplace. Employers report taxable benefits and reimbursed expenses to HMRC on forms P11D after the end of the tax year. The rules for travel and subsistence expenses were recast in the 1990s; although the rules have been in operation for less than 20 years, the OTS has regularly been told of practical problems with the rules.

A review into employee benefits and expenses could bring simplifications to 4 million employees and 400,000 employers reporting taxable amounts, as well as many others with non-taxable expenses.

There are over 150 pages of tax and NIC legislation, alongside many pages of HMRC guidance.

Project coverage

In more detail, it is envisaged that the project would cover both legislative simplifications and improvements to HMRC's administration, including the form P11D process.

The review will not cover the underlying principle of taxing car benefits based on CO2 emissions, which contributes to the Government's green policies.

The review should have regard to:

- Current trends and practices in employee reward
- Whether tax rules have kept pace with developing practices
- The impact on employers and employees;
- The cost/benefit to the Exchequer;
- Operational impacts on HMRC, including any interactions with the RTI programme
- International experience (especially that of the Irish system);
- Interaction with other legislation;
- Fairness and consistency of treatment of taxpayers; and
- Any necessary anti avoidance measures.

Any recommendations for simplification made would have to be in line with the OTS's remit to be broadly revenue neutral in its work.

The Office's work will be informed by consultation with interested parties, including forming and working with a consultative committee.

The OTS will report back to the Government on stage 1 of the exercise in Spring 2013; that report will include identifying priority areas for the second stage of the review and will set out the proposed timescale for the following stages of the review.