Office of
Tax Simplification

Review of employee benefits and expenses: Interim report

August 2013

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ISBN 978-1-909790-26-1
PU1552

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Foreword

A quick glance at any jobs website will show the plethora of benefits on offer. Season ticket loans, relocation grants, share ownership plans, private health plans, cycle to work schemes – the list goes on and on. The choice for both the employee and employer is often complicated by tax issues. Different benefits are taxed in different ways, with the amount often based on how you get the benefit rather than what the benefit is. National insurance is another complex area. The rules are often slightly different to the tax rules, for no obvious reason and there are three classes of contribution to deal with.

Expenses are also a tax minefield. As we've gone round the country talking to people, everyone said they found it difficult to know when travel and subsistence expenses were allowable for tax and when they weren't. The rules were last updated in the late 1990s and focus on not allowing the costs of "ordinary commuting". But that term is becoming increasingly blurred in today's job market, where much more flexible ways of working are becoming popular. People now find themselves managers of teams working across several workplaces or work on the move from home.

We wanted to tackle the whole area of employee benefits and expenses because so many people were telling us how complicated it was. Small businesses in particular don't have time to read the hundreds of pages of HMRC guidance. They tend to muddle through until they get a nasty surprise after a visit from the taxman. Big employers told us they spent huge amounts of wasted time keeping records of expenses and trivial benefits that were never going to be taxed or, in their view, shouldn't be. As some put it, 'benefits should mean benefits'.

As with all our projects, we set about the task with an open mind, travelling the length and the breadth of the UK to speak to employers and their advisers. In the course of over 50 meetings a clear pattern has emerged of the priority areas for the next stage of our review.

As ever, HMRC's administration comes up time and time again as a bugbear. The P11D process is a burden for employers. It is widely misunderstood and often leads to incorrect tax codes. Travel and subsistence is the next biggest issue we've found. Most people said they didn't want radical changes, just some tweaks to bring the rules up to date. We also found that accommodation benefits and termination payments caused problems for a sizeable number of people, and there are issues with other benefits too.

My thanks go to all those who have contributed to this report, especially the OTS team who did the bulk of the work – Suzy Giele, Theresa Dendy and Tracey Bowler. I am extremely grateful to the members of our Consultative Committee who gave us plenty of challenge and encouragement along the way.

Finally I'd like to thank all those organisations and people who took the time to meet or write to us with their views. With so many people contributing to our work from all over the country we feel that this "bottom up" input gives a real practical authenticity to the project.

Rt. Hon. Michael Jack
Chairman, Office of Tax Simplification

Executive summary

Introduction

This is the interim report for the OTS project on employee benefits and expenses. It is intended to be a summary of what we have heard from people in our travels around the country, speaking to employers big and small, their advisers, representative bodies and HMRC frontline staff. We have tried to reflect fairly what people have told us, highlighting where the system is most complex for them.

This is not a set of fully worked up proposals. Our remit for this stage of the review was to report areas of complexity and recommend priorities for further review. That is what we have done.

However, we have also given some thought to a number of "**big picture**" issues, listed in Chapter 1. These have come to the fore as we have spoken to people and researched the subject. We do not present these as definite solutions, but all of them show real promise as simplifying measures and we would be interested in exploring at least some of these in more depth.

We have also come across a number of what we think could be "**quick wins**", changes that might make things simpler in the short term and which could be effected easily. We list these in Chapter 2. They are not fully thought through, and carry a health warning. But they have all been raised by people we have spoken to (including in some cases HMRC), are based on their practical experience, and seem to be things that could be 'fixed' quickly and usefully.

Tell us your thoughts

We would be very interested in people's thoughts on the "big picture" issues we highlight in Chapter 1 and the quick wins in Chapter 2.

We'd also like to know if there's anything important you think we've missed in this report, or if we've got something wrong.

You can e-mail John Whiting and the review team at **OTS-Employee.Benefits@ots.gsi.gov.uk**.

Any overall comments should ideally be sent to us **by mid-September**, as we will then be embarking on the next stage of our review. But, as with all our reports, input would be welcome at any time, particularly on the issues in Chapters 4-7 that we are likely to be taking forward in the autumn. We would be happy to meet with groups with particular interest in these areas, or receive comments as we develop our thinking and work up formal recommendations for simplification. We plan to publish our recommendations in stages, some before the end of 2013 and some in January/February 2014.

The taxation of employee benefits and expenses affects a large proportion of the taxpaying population and every employer, large or small, profit-making or charitable needs to be able to understand and use the rules. A review into employee benefits and expenses could bring simplifications to around 4 million employees and 300,000 employers reporting taxable amounts, as well as many others with non-taxable expenses.

The OTS Reliefs Review[1] identified a number of complexities around the taxation of employee benefits, including different rules for tax and NICs, the £8,500 benefits threshold, and some small benefits that are exempt from tax. The OTS Small Business Review[2] identified the process for reporting benefits on P11D forms as particularly burdensome for employers. Other complexities we found were the tax rules for benefits, as well as practical issues around some benefits and redundancy payments. Our Share Schemes Review[3] identified some of HMRC's administration as particularly complex, including the form 42 for reporting share awards, and the complexity of getting HMRC approval for some tax advantaged schemes.

Too often it appeared to us that the tax rules for employee benefits and expenses are not keeping up with the changing demands of the workplace environment and remuneration methods. We also heard that people are increasingly finding themselves taxed on something they never considered a "benefit". Things like staying in a cheap hotel whilst working on a contract, or receiving a bunch of flowers when you've been ill.

The feedback we were getting on our other reviews led us to propose this project to Ministers, who readily agreed that we should tackle the whole area of employee benefits and expenses.

Our remit

The terms of reference for this Review proposed that it would be an opportunity to examine the way working patterns have changed since the various tax rules were developed and question whether the rules are still appropriate and efficient. The aim was to cover both legislative simplifications and improvements to HMRC's administration, including the form P11D process. Our terms of reference also tasked us to look at:

- 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);
- interactions with other legislation;
- fairness and consistency of treatment of taxpayers; and
- any necessary anti avoidance measures.

Our approach to gathering evidence

This report is based on intensive work carried out by the OTS in the last three months. It incorporates feedback from more than 50 meetings and seminars we conducted around the country, conferences we attended and written comments we have received, as well as comments from our Consultative Committee of experts (whose details are in Annex A).

[1] https://www.gov.uk/government/publications/tax-reliefs-review.
[2] https://www.gov.uk/government/publications/small-business-tax-review.
[3] https://www.gov.uk/government/publications/employee-share-schemes-review.

We have sought the views of as wide a range of people as possible, talking to representative bodies as diverse as the Church of England and the National Farmers' Union; large business and small business, universities and local authorities; payroll managers and software manufacturers; tax advisers in large and small practices and a range of HMRC teams and specialists. We have ranged from Belfast to Bournemouth and from Glasgow to Bristol (our meetings are listed in full in Annex B). We researched the history of the rules seeking out the original policy rationale from documents in the HMRC library and we have looked at different approaches taken by overseas jurisdictions.

Key points

The key points emerging are:

- **the system has developed in a piecemeal fashion** over the last 65 years. Many would say that it is ripe for a complete review although we recognise that this raises significant resource issues for both employers and HMRC in dealing with any new system. In an ideal world though **we would recommend a full policy review of the whole benefits and expenses system to re-establish some general principles and ensure these are in line with current employment practices and government policies**;
- **underlying much of the complexity are tensions and boundaries in the tax system** which we have referred to before, such as the **differing income tax and NICs rules** and the **differing rules for the taxation of employed and self-employed**. We continue to maintain that these underlying structural issues cause significant problems within the tax system;
- **HMRC administration including the form P11D process and the issuing of tax codes is a major source of concern amongst employers**. The process is resource intensive both for employers and HMRC and is often driven by complex and frequently misunderstood rules as to what should or should not be included. It should be **a key priority for further work** to identify what changes can be made to simplify the system;
- the area about which we have received the most comment is that dealing with **travel expenses and subsistence**. This is an area which particularly highlights how the tax rules now fail to reflect normal commercial behaviour. It is an area we would **recommend as another priority for further work** in the next stage of this review;
- the rules dealing with **accommodation** for employees and **termination payments** give rise to significant problems in practice, even though they affect fewer people; and
- through our initial work, we have identified 43 "quick wins" (see Chapter 2). These are items that could be changed quickly to useful effect; we may add to them as this project progresses.

Structure of the report

This report identifies the "**big picture**" issues in Chapter 1 which have become apparent in conducting the work to date. It then considers possible "**quick wins**" that could lead to simplification without significant underlying rule changes, and hopefully without much controversy. We then include some important statistics about this area of the tax system. The report then sets out in more detail our findings in relation to the four areas we have identified as priorities, set out below. Briefer consideration of other areas, including some simplification ideas, is set out in Chapter 8. The report concludes with a series of Annexes, including details of income tax and NIC differences in treatment of expenses and benefits.

Priority areas for further review

We recommend four priority areas for further study by the OTS. These are, in order of priority:

- HMRC administration, including the P11D process and PAYE Settlement Agreements PSAs)[4];
- travel and subsistence expenses;
- accommodation benefits; and
- termination payments.

The main reason we put these four areas forward is the frequency with which they came up at meetings, both with taxpayers and HMRC staff. But we also took into account the complexity of the legislation and guidance, the number and type of employers and employees affected, and the chances of achieving real simplifications in the short term.

Ideally we would like to tackle all these areas immediately, but if we were to prioritise, we would want to look at HMRC administration and travel and subsistence expenses first. These could bring the biggest simplifications to the most people in the shortest time.

The rules for accommodation benefits are outdated and often unfair or illogical. However, only a relatively small number of people are potentially affected and changing the rules could disadvantage some people. A small step in the right direction would be to modernise the system of valuing accommodation so it is no longer based on 1973 property values. Beyond that, much could be achieved by improving HMRC's guidance and consistency in allowing exemptions, especially the "customary" test. There are also possible interactions with National Minimum Wage legislation.

Termination payments have come up in a lot of meetings, but they were only a real issue for some of those who attended. The £30,000 tax exemption was last updated in 1988, and contrary to popular belief does not apply to all termination payments. The policy for the exemption has become muddled, and the Government needs to decide what it wants to do with it. This is an area which could benefit from a through policy review, which is beyond the remit of the OTS. Some ideas to consider might be reviewing the level of the exemption, rethinking the restrictive NICs exemption, and clearer HMRC guidance.

Next steps

We will discuss this report with Treasury Ministers over the summer, and agree priority areas to take forward in the next stage of our review. We plan to publish our recommendations in stages, some before the end of 2013 and some in January/February 2014.

[4] PSAs are arrangements where employers agree with HMRC to pay tax on behalf of employees for certain benefits.

1 "Big picture" issues

1.1 There has not been a fundamental policy review of the taxation of employee benefits and expenses since the 1970's. It has become clear to us that the piecemeal development of the rules has resulted in a complex and unwieldy system which we are hearing gives rise to significant costs for many employers and causes confusion for many employers and employees. One option would therefore be to **undertake a full policy review of the whole benefits and expenses system to establish some general principles** which might then lead to clearer, simpler guidelines for many areas and ensure that the tax system is in step with government priorities.[1] However, we are aware of the significant resources issues caused by such change, both for employers and HMRC. We do touch on the key questions which would need to be addressed later in this chapter.

1.2 Even without a wholesale review of the employee benefits and expenses system, there are some fundamental "big picture" issues which our review highlights:

- **When is a benefit really a benefit?** Although this is strictly a policy issue beyond our remit, we are getting lots of comments from people who question the whole rationale for taxing things that employees don't think is a real benefit. For example, is it right that the costs of a physiotherapist provided to workers carrying out heavy manual jobs is taxed as a "benefit"? We touch further on this later in this chapter;
- **Can the administration of the employee benefits and expenses system be substantially modernised, streamlined and simplified?** For example, **"payrolling" of benefits** comes up at every meeting we go to with employers. They want to be able to pay the tax on some benefits through the monthly payroll, applying PAYE rather than waiting for the end of the year to file a form P11D. Similarly, **Nil P11Ds** are a big issue for people, where employers have to report a reimbursed expense that will never be taxable because the corresponding employee expense is allowable. They want to be able to operate a "self-dispensation" process where they decide themselves that something does not need to be reported because it is not taxable (by reference to a HMRC list), rather than agreeing this in advance with HMRC. We discuss aspects of this below and consider the area in more detail in Chapter 5;
- **Many of the exemptions and allowances in the system are outdated.** Should they be retained? What is the policy behind them? Are items such as personal incidental expenses still intended to be useful? If so, they need to be increased significantly; and
- If a wholesale policy review along the lines suggested in paragraph 1.1 is not practical, there are definitely discrete areas that need a review and possibly restatement of government policy. Examples are the policy for **termination payments** (how to tax – or exempt – termination payments?) and **overseas travel, including removal expenses** (is the tax system supposed to encourage, discourage

[1] As an illustration, the rules on removal expenses seem to serve to make it more difficult for universities to hire overseas academics – something they are encouraged to do by the Department for Business Innovation & Skills – see Chapter 8.

or simply be neutral?). Again, this is beyond the remit of the OTS but we think the Government needs to consider these issues. We consider termination payments further in Chapter 7 and removal expenses in Chapter 8.

1.3 Apart from these issues, our review has brought into focus underlying structural issues regarding the system of taxing employee benefits and expenses, some of which have been considered by the OTS in earlier reviews:

- the distinction between those earning more than **£8,500** and those earning less than £8,500;
- the tax treatment of benefits is often dependent on the **mechanism of payment** or provision of a benefit by the employer rather than what is actually provided;
- the problems of the **different income tax and National Insurance** rules;
- the differing rules applying to the **self-employed and the employed**;
- the different considerations applying to **small business and large business**;
- whether there should be an exemption for **trivial benefits**; and
- the **lack of knowledge** amongst employees and smaller employers of how the tax system applies to them.

1.4 We explore these "big picture" issues, as well as the alternatives to piecemeal development, in a little more detail in this chapter, but our remit is not to make recommendations at this stage of our review. We would like to consider at least some of these issues as part of the second stage of our review, but are conscious that some of these are very wide ranging areas that may be too big for us to tackle at the moment.

Streamlining administration: payrolling and self-assessed dispensations

1.5 Payrolling benefits – putting amounts into the payroll, charging PAYE and NICs and thus clearing all tax liabilities – has as noted above been a frequent issue at meetings. It is not a new issue: payrolling of benefits was the subject of an HMRC consultation exercise in 2007-08. At the time, the aim was payrolling of all benefits for all employers. It was generally rejected by consultees because of this compulsion: difficulties that small employers would probably face in managing the process and which all employers would face over valuing some benefits. It is clear from our meetings that a large proportion of employers would welcome the ability to payroll benefits – provided this was optional in terms both of which benefits are payrolled and whether an employer uses the system. We think that developments in payroll software since the previous consultation (and the advent of RTI) make payrolling an obvious route to go. The vision should surely be that this could lead to abolition of P11Ds, by a combination of:

- payrolling benefits where the amounts are effectively fixed;
- dispensations, facilitated by clear HMRC listings/criteria and effected on a self-assessed basis to eliminate many sundry items; and
- PAYE Settlement Agreements (PSAs) for the rest of the benefits given.

1.6 We consider the administrative aspects of these issues further in Chapter 5. There are obvious NIC issues, which are considered further at paragraph 1.34 onwards.

The £8,500 threshold

1.7 This is an issue we have commented on previously in the interim report of the Small Business Tax Review[2] and in the final report of the Review of Tax Reliefs.[3] We have previously suggested further work should be done to assess the impact of removing the £8,500 "higher paid" distinction.

1.8 When the benefits code was first introduced in 1948 a threshold, known as the "higher paid" employees threshold, was set at £2,000 of emoluments (including the value of the benefits) for the application of the new rules to employees who were not directors. At this time the average earnings in the UK were £305 per annum, so the £2,000 level was 6.5 times the national average wage.[4]

1.9 Since 1948 the threshold has been increased on three occasions to the current level of £8,500 set in 1979.[5] In 1979 £8,500 was chosen as being broadly equal to the level at which a married man started paying tax at the higher rates.

1.10 Indexation of the threshold has been considered over the years and rejected and by the mid 1980's the decision had been taken to allow the threshold to "wither on the vine".[6] The reason for not abolishing the threshold was the additional cost to HMRC of handling the additional filing for all employees. However, we expect that the numbers involved now would be small: HMRC tells us that fewer than 20,000 P9Ds[7] are filed each year.

1.11 If the £8,500 limit had increased in line with inflation it would be £39,139 in May 2013.[8] In 1979-80 it was 150 per cent of average full-time earnings. In 2012-13 it was only 35 per cent of average full-time earnings.

1.12 The personal allowance is being raised to at least £10,000 from April 2014.[9] This makes it even more difficult to see a good reason for the threshold being retained at £8,500.

1.13 The threshold causes complexity in the following ways:

- some benefits are taxable on all employees (e.g. accommodation) whereas others (e.g. private medical insurance) are only taxed on the 'higher paid'. The reasons why these distinctions remain are unclear;
- employers are required to prepare and file P11Ds for higher paid employees and the employee is taxed on all benefits (except those that are specifically exempt). For lower paid employees P9Ds are prepared and submitted for those below the threshold and the employee is only taxable on certain benefits, i.e. vouchers, living accommodation and those benefits that are readily convertible into cash; and
- the taxable value of a benefit to an employee varies depending on whether the individual is a lower paid employee or not. Lower paid employees are taxed on the market value of the benefit, whereas higher earners are taxed on the greater of cost to the employer and market value, which can lead to complexity, as shown in Box 1.A.

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199183/05_ots_small_business_interim_report.pdf.
[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/198570/ots_review_tax_reliefs_final_report.pdf.
[4] The Office for National Statistics Annual Abstract of Statistics 1948.
[5] It was increased to £5,000 in 1975, £7,500 in 1977 and £8,500 in 1979.
[6] HMRC internal notes to the Finance Bill 1984.
[7] The equivalent of P11Ds filed for those earning less than £8,500.
[8] The retail price index for May 2013 was 986.3 and for April 1979 was 214.2.
[9] For those born before 6 April 1948 the allowance increases according to whether an individual is born before or after 6 April 1938.

Box 1.A: Example of different taxable values either side of £8,500 threshold

A media company purchases two identical televisions and gives one to a higher earner and one to a lower earner.

The lower paid employee will be taxed on the market value of the TV (i.e. the second hand value) whereas the higher paid employee will be taxed on the original cost, if higher.

1.14 At almost every meeting we held, the subject of the £8,500 threshold came up in the discussions. Although there is this difference in treatment under the rules, we have been told by businesses and advisers that the different rules are frequently ignored in practice with employers treating everyone as "higher paid". There may be cost savings in terms of tax if the calculation was performed, but these are likely to be outweighed by the related administrative and compliance costs. This can also result in unfairness, where some employees who are not "higher paid" are nevertheless subject to tax on their benefits as if they were higher paid. However, ignoring the "higher paid/lower paid" differences is not universal and if an employee changes job they may find their tax treatment alters just because of differing approaches taken by different employers. This in itself can be expected to cause confusion.

1.15 Low paid employees who receive employment benefits are typically found in three types of employment:

- in small companies, typically spouses and wider family members;
- in large companies, part-time workers and some non-executive directors; and
- in the charity sector.

1.16 Without carrying out a proper investigation, we did try and identify benefits that would be caught by an abolition of the £8,500 threshold. Various situations were raised, including:

- private healthcare for some part-time staff;
- car benefits for family members at a small company;
- travel expenses for part time staff at a charity (travel for unpaid volunteers was also cited to us as an issue under this heading, although it may be more an illustration of the lack of clarity in the rules); and
- accommodation benefit for staff at a hotel (the meeting pointed out that this was taxable irrespective of the pay given!).

1.17 It was interesting to note that one major employer in the retail sector who agreed they had a number of sub-£8,500 (part-time) employees were clear that they did not monitor the threshold. Their explanation was that such staff would not get any relevant benefits.

1.18 Most employers see the £8,500 limit as an anachronism and the great majority of people saw it as something that needed to be abolished as being redundant. The minority view was that it should be increased significantly, with some suggesting it went up to average earnings and others suggesting that it should be tied to the higher rate income tax threshold (with the implication that some benefits at least would only be taxed to higher rate tax, in some peoples' minds).

1.19 If the limit were increased to around £40,000 in line with inflation, we could expect a substantial reduction in the number of P11Ds to be submitted and an increase in the number of P9Ds. There would also be a considerable Exchequer cost as many taxpayers would no longer be taxed on some benefits. We have not tried to estimate that cost.

1.20 However, this would not really be a simplification of the system. The differing tax treatments and administration would remain and the position would be worse for many employers who currently do not have any employees to whom the £8,500 threshold applies, i.e. all their employees earn more than £8,500.

1.21 **It is tempting to include the abolition of the £8,500 limit on our list of 'quick wins' but we think more work needs to be done to assess the impact of abolition. It does seem, though, that life has moved on since the last time that abolition was considered.** We return to this issue in Chapters 5 and 8.

Tax treatment dependent on mechanics

1.22 Various parts of the employee benefits and expenses system tax employees differently depending upon the **way** in which they are paid or the benefit is provided, not **what** they are being paid or provided. Examples include sporting and recreational facilities, training, computers and nursery provision.

1.23 **Sporting and recreational facilities** – if the employer provides sports facilities, such as a gym, the employee is not taxed on the benefit of using the gym. However, if the employer pays for an employee to use a local gym available to members of the public, the employee is taxable on the benefit of the gym membership. Not only is this confusing for taxpayers, but it also causes problems for smaller businesses which are not able to provide in-house facilities.

1.24 The taxation of some items differs according to whether the employer or the employee pays for them. For example, if the employer pays for training the employee is not taxable on the benefit provided,[10] but if the employee pays for the same training the employee cannot generally obtain a deduction for the expense of that training.[11]

1.25 Employers are increasingly asking or inviting employees to bring their **own computers** to work to do their work. If the employer loans a computer to the employee to carry out work then there would be no charge on the value of the computer, but if the employer makes a contribution to the cost of the employee's computer (or buys software for the computer), then depending upon the detailed facts, the employee may be taxed on that as earnings or as a benefit.

1.26 The differing tax treatment of payments for goods or services obtained by an employee by virtue of his employment causes significant confusion and mistakes. Table 1.A summarises the differences for an employee whose employer is paying for a phone line and also highlights again the complexity added by the £8,500 threshold.

[10] Section 250 ITEPA 2003.

[11] If the employee is reimbursed then the cost is ultimately borne by the employer and the employee is not taxed on the reimbursement.

Table 1.A: Different tax and NIC outcomes for providing a telephone line

Who contracts with the phone company	Who pays	Employee below £8,500 threshold	Employee at or above £8,500 threshold
Employer	Employer	No tax or NIC	Amount paid is reported on P11D Class 1A NICs on that amount
Employee	Employer	Report on P9D Apply Class 1 NICs	Report on P11D Apply Class 1 NICs
Employee	Employee (who is then reimbursed by employer)	Deduct PAYE on reimbursement and apply Class 1 NICs	Deduct PAYE on reimbursement and apply Class 1 NICs

In each case the employee ends up receiving the same economic benefit but the income tax and NIC treatment varies.

1.27 The situation is probably most extreme in the case of an employee going to a petrol station to purchase petrol for his own car (not a company car). In order for the payment to be subject to Class 1A NICs rather than Class 1 NICs the employee is supposed to go to the forecourt attendant before starting to fill the car and say he is purchasing the fuel on behalf of his employer. The attendant has to "accept" this and then the employee fills the car with petrol.[12] One person told us they tried to put this "litany", as it is known, into practice once and the attendant was unable to understand what she was saying or requesting. We suspect this completely unrealistic rule is hardly ever used and "pay at pump" machines just add to the confusion.

1.28 The OTS would like to explore the feasibility of changing the basis of taxing benefits so you are taxed on what you receive, not how you receive it.

Difference between income tax and NICs rules

1.29 Differences between income tax and NICs rules are a fundamental factor of complexity in the UK system, as the OTS has pointed out in both our Review of Small Business and the Review of Reliefs. We have recommended a series of moves towards a full merger of tax and NICs, stressing that there were significant simplification gains in each stage and these could be achieved without committing to a full merger of the taxes. The Government acted on our recommendation and established a project that has issued a consultation document, but it is clearly a huge project that cannot be achieved quickly; in addition, we suspect RTI has taken priority of late. However, so much of what we have seen through the current project has reinforced our previous recommendations: this is an area where progress really does need to be made.

1.30 One fruitful area that would help to progress the Income Tax-NIC project would be to start aligning the rules around employee benefits and expenses. The different rules are a concern raised on many occasions by consultees, representing large and small business as well as HMRC staff and advisers. Annex E sets out the detailed differences.

1.31 Box 1.B gives an example of one difference between NICs and tax.

[12] See http://www.hmrc.gov.uk/manuals/nimmanual/NIM06054.htm.

Box 1.B: Example of the complexity caused by differing NICs and tax rules

An employer provides a phone at home to an employee which the employee uses for personal as well as work purposes. The total cost for a year is £1,000: £550 is for business calls, £150 for line rental and £300 for personal calls.

Income Tax: the employer must report £1,000 on the P11D and the employee can then claim a deduction of £550 for the business use of the asset.

NICs: The employer will be subject to Class 1A contributions on £1,000 as apportionment is not generally permitted for mixed-use assets unless private use is not significant.

1.32 The disparities give rise to costs for employers, who need to run systems to identify and deal with the differences and for HMRC in applying the differences. The complexity arises from three main areas:

- the **differences between the underlying income tax rules and the NICs rules** as illustrated by Box 1.B above. Also, Table 1.A shows how even the mechanics of how a payment is made or benefit provided can lead to different tax and NICs treatment;
- the **differences in accounting** for NICs and PAYE for various items. The NICs on benefits that are subject to Class 1 will be collected during the year, through the PAYE system, while the tax on these items will be reported after the end of the tax year, meaning that the employer will need to deal with them twice. Class 1A NICs and the P11D are both due by 6 July after the end of the tax year. However, further complexity arises if an employee makes a payment towards the cost of a benefit on which Class 1A NICs has been paid. In such circumstances generally the employer cannot reclaim the Class 1A NICs as the conditions for reclaiming NICs are much tighter than those for income tax; and
- the **two classes of employee NICs**, Class 1 and Class 1A, which can apply.[13]

1.33 Although there have been steps taken to align employee tax and NICs, significant differences remain. This reflects the piecemeal development of the tax rules and the NICs rules since 1948. The long and detailed chart of differences in HMRC's Employers' Guide CWG2 (2013) in itself highlights the complexity and confusion of the current system. The timeline in Annex D includes the various steps towards closer alignment but there is much left to do. Alignment in the context of benefits and expenses would be a major way of simplifying the system.

1.34 Many consultees have told us that applying **just one class** of NICs to benefits and expenses would be a significant simplification. Representative bodies and employers have told us about the considerable problems caused by having multiple Classes of NICs applying to employee benefits and expenses.

1.35 However, merging the two main classes into one raises significant issues going to the heart of the NICs system even though employers' secondary Class 1 NICs and Class 1A NICs are both at the rate of 13.8 per cent. This is because Class 1 NICs are payable by employer and employee and the employee NICs contribute towards employee state benefits, whereas Class 1A is payable only by the employer and is non-contributory. If all benefits become chargeable to Class 1 NICs the tax cost to employees would increase. If all benefits became chargeable to Class 1A NICs the

[13] Plus the third category of Class 1B NICs which applies to PSAs.

current Class 1 NICs paid by employees would be lost. Such changes would have an impact on contributory benefits – and also on tax credits/universal credit where these are calculated by reference to net income.

1.36 Logic would certainly dictate that the same rate of NICs would apply to cash pay and benefits, and be payable by the same people. This would in principle be a simplification and a more fiscally neutral system for cash and benefits. With such a change, some adjustment in the rate of NICs would need to be considered.

1.37 The NIC issue needs to be addresses properly if payrolling becomes widely available. **Further work is necessary to determine the amounts at stake (and the wider implications for contributory records) if all benefits became subject to Class 1 or, instead, Class 1A.**

The self-employed/employed distinction

1.38 It is often difficult for the man in the street to see why there should be different expenses rules for the employed and the self employed. This is another "big picture" issue that the Government needs to address from a policy perspective.

1.39 The general rule for deduction of expenses by a self-employed person is more generous than for an employee. The employee rule was introduced in 1853 and has survived in much the same form: the employee is entitled to claim a deduction for expenses which he is **obliged to incur and the amount is incurred wholly, exclusively and necessarily in the performance of the duties**.[14] This is supplemented by specific rules for travel expenses.

1.40 In contrast, a self-employed person may deduct expenses incurred **wholly and exclusively for the purposes of their business** and this usually results in a more generous ability to deduct expenses. There are some exceptions to this more generous treatment. For example, the rules for temporary workplaces are less generous for the self-employed than for employees – we understand HMRC regard the limit as being six months instead of two years; and the self-employed cannot get deductions for training that creates new skills, just for training that maintains existing skills. Other differences also arise: for example, the self-employed may have assets provided to them for their use (e.g. a van) but in contrast to an employee provided with the same asset, no charge will arise unless legal title to the asset is also transferred.

1.41 There have been many criticisms over many years of the harshness of the employee expenses rules and suggestions made to narrow the gap between those rules and the rules for the self-employed.[15] On the other hand, some argue that the differing treatment of the self-employed is counter-balanced by the limitation on their ability to claim benefits. It also, of course, reflects that they are in business and could be seen as recognition of the entrepreneurial activities. In addition, some benefits, which would normally be personal expenditure of a self-employed taxpayer and so non-deductible, are covered by exemptions for employees: for example, certain relocation expenses and sports facilities.

1.42 However, modern working practices mean that there has been a considerable increase in the number of people who are self-employed,[16] and we are told by recruitment agents that people not only move jobs more frequently but also move in and out of employment and self-employment. The current rate of change in employment may mean that there is now a greater

[14] Section 336 ITEPA 2003. Interestingly the rule did not always apply to all employees. Many were originally subject to the more generous Schedule D rules until a judicial decision resulted in all employees being taxed under Schedule E.

[15] Codification Committee, 1936; Royal Commission on the Taxation of Profits and Income, 1955; Institute of Taxation, 1989.

[16] There has been an increase in self-employment from under 2 million in 1979 to 4.2 million in 2013 according to the Office of National Statistics.

need than before for employees to maintain and develop their skills at their own expense and to incur expenditure on equipment to improve their work.

1.43 We have been told that working relationships have altered with more people working for more than one employer or perhaps being both employed and self-employed at the same time. New technology and improved transport enables employees to live further from their employer's offices and to work from home. Consultees have expressed concern that the result can then be an employee and a self-employed person working side by side incurring similar expenses and undertaking similar duties but with significantly different taxation and, in particular, significantly different abilities to deduct expenses.

1.44 The limit on tax deductibility of what people would expect would be deductible expenses, such as employee funded training for work, therefore is increasingly at odds with the current working environment. We are of the view that where possible the tax rules should make sense in the environment in which they operate.

1.45 It is beyond the scope of this paper to consider ways of limiting the difference but we do draw attention to it as a structural element of the current system which merits further consideration.

Large and small business differences

1.46 Generally, large businesses have told us that any expenses they incur or benefits they give are for business reasons. They have their shareholders to account to and the commercial world is competitive.

1.47 On the other hand, we are told that for some small businesses the distinction between business and private expenditure becomes blurred. We were told in the Small Business Review that many small businesses hold money within the company as a "piggy bank", drawing on the funds when needed, but this can give rise to unexpected benefit in kind tax charges.

1.48 Large businesses often devote considerable resources to payroll management. Simplification of the rules and the processes would be welcomed by them to reduce these costs.

1.49 However, small businesses often do not have the resources to devote the same level of attention to the intricacies of the employee benefits and expenses system. They may not even be aware that there are any tax issues at all as a result of providing certain employee benefits. This means that they can miss some of the complex technical rules and will only discover a problem some years down the line on a PAYE audit visit by HMRC. We have been told that often it is benefits of small value or differences caused by the mechanics of provision (see Table 1.A) which catch out small employers.

1.50 In addition, consultees have commented that some of the techniques used by larger business to take advantage of lower costs for particular structures, such as salary sacrifice, are not accessed by smaller business because of lack of understanding and/or resource.

1.51 The tax system should not depend upon the employer's level of advice or resources devoted to knowledge and application of the rules. It should be clear and accessible to all. A small business may easily fall into traps at the moment. For example, it is all too easy for the owner of a business to give a member of staff a bottle of wine or bunch of flowers for a job well done and not realise that this is a taxable benefit.

1.52 We have also received many comments about the burdens of the reporting requirements for employee benefits and expenses (discussed further at Chapter 5). Some consultees though have told us that smaller businesses in particular often welcome the time lag after the year end

for the P11D reporting. This gives the payroll person or persons time to identify the relevant items. Payrolling of employee benefits and expenses would probably not be welcomed by those businesses. However, some larger businesses have said that they would welcome this, at least as an option and a few appear to be doing this already.

1.53 However, we have received consistent and frequent comment from business that the reporting of expenses for which the employee can then claim a deduction seems to be an unnecessary burden. While a dispensation may assist there may still be some payments not covered by the dispensation. A welcome simplification for business and especially small business, would be some form of self-certification that items have only been excluded from reporting for which the employees are entitled to deductions.

1.54 These differences suggest there may be a case for different tax rules for large and small businesses, rather than the current "one size fits all" approach. **We would propose further investigation into how the system could be made to work better for business generally and, in particular, for small business, considering not only the application of the underlying tax rules but also HMRC's administration of the system, discussed further (see Chapter 5).**

Trivial benefits

1.55 The rules regarding trivial benefits illustrate the points made to us regarding complexity, inconsistency and the system being difficult to understand or relate to modern working practices. Under current rules HMRC may agree that benefits which are "trivial" are not worth reporting as long as those benefits fall within certain criteria.

1.56 "Trivial" is not defined. We have received comments from representatives of business that HMRC's practice is highly inconsistent as to the amount accepted as "trivial". Even when an amount is agreed, for some the cost of recording the trivial benefits, to make sure the agreed amount is not breached, is so cumbersome that it is easier to account for everything as a benefit.

1.57 The criteria as to what is or is not a trivial benefit are detailed and confusing for employers. To go back to the example of the bunch of flowers or the bottle of wine, if that gift is for a job well done it cannot count as a trivial benefit but if it is to celebrate the birth of the employee's child then it can be. Vouchers cannot be a trivial benefit, but we have been told that some employers like to use them rather than particular gifts in order to give their employees more choice over their gift and for cultural reasons. The rules catch out employers unnecessarily and do not reflect modern working practices.

1.58 One option for dealing with this would be to consider **a fixed monetary limit for items which do not need to be reported**. Restrictions such as what a trivial benefit is for could be removed and the rules simplified. This has been introduced in Ireland, where one small benefit of up to 250 Euros value per employee per year is exempt.

1.59 That approach only deals with one benefit per year and the evidence we have heard from business suggests that an aggregate figure which could pick up various small items would be a greater simplification gain. However, businesses would still need to track the individual benefits by value to check that the total has not been breached. Another route would simply be for HMRC to publish a clear list of what they regard as 'trivial', to save employers having to do their own negotiations about what is trivial.

1.60 Further comments on the subject of trivial benefits are contained in Chapter 8.

The lack of knowledge amongst employees of how the tax system applies to them

1.61 We have heard from consultees that for various reasons employees often have little understanding of how the employee benefits and expenses tax rules work in their circumstances. The PAYE system in itself encourages employees to feel there is less need to take responsibility for their tax. The system deducts the tax each month automatically and the system has been represented for many years as getting to the right answer without any need for the employee to become involved. It is worth noting that in a separate initiative to help tackle low levels of understanding about tax among the employee population, the Government has announced a new Personal Tax Statement for around 20 million taxpayers, provided from 2014-15. This will detail the income tax and National Insurance contributions (NICs) they have paid, their average tax rates, and how this contributes to public spending.[17]

1.62 We also heard in almost every meeting that tax codes are often wrong. There is too great a delay in the coding after P11Ds and once an item gets into an employee's coding it seems to be very difficult to take it out again. We are also hearing that employees do not understand what expenses they can claim for or how to go about making the claims. Flexible pay and salary sacrifice arrangements also cause confusion among employees because of P11D reporting requirements. These issues are discussed further below in Chapter 5.

1.63 This disconnect with the tax system increases the vulnerability of employees to persuasion by "high volume agents" to make claims for expenses which have insufficient basis. We have been told by HMRC that the proportion of these being rejected is very high, but that process of rejection costs HMRC time and money and the employees potentially feel even more disconnected from the system and could end up as losers, if HMRC investigates incorrect claims.

1.64 Steps such as improving the web-based guidance and user-friendliness of forms, such as the expenses claim form P87; and providing a clear web-based list of what expenses are generally deductible would assist. Improving the accuracy of the tax codes would be another significant step. Making provision for employers to say whether a benefit is continuing or simply a one-off would stop such one-offs being trapped in codes. A more radical alteration to the tax reporting system would be required to engage employees further in the tax process, such as introducing universal returns as other jurisdictions use. However, this would not be a simplification for the many people who get the right answer under the PAYE system with no intervention required.

The piecemeal development of the benefits code – time for a new approach?

1.65 While the legislation setting out the requirements to deduct expenses has changed little in 160 years (albeit that a significant body of case law has developed to interpret that legislation,) the development of the benefits code has been very different. In 1892 the courts decided that only things which could be turned into money were taxable as income.[18] This opened the way to numerous methods of providing employees with non-taxable remuneration until the first steps to roll back the tide took place in 1948 when the benefits code was first introduced. A major extension of the provisions took place in 1976 but since then legislative development has been generally piecemeal, either to counteract avoidance (for example, the voucher rules,) or to provide incentives for particular behaviour (for example, the cycle to work scheme).

[17] Budget 2012 (p35).

[18] Tennant v. Smith 3 TC 158.

1.66 However, despite the anti-avoidance motive being the driver of much of the legislation it remains the case that **remuneration in the form of non-cash benefits is often considered more tax efficient for employers than payment in cash**. This varies from benefit to benefit. Accommodation is an example of a benefit where it can be considerably more tax efficient to provide the employee with the benefit – the accommodation – than with cash to pay for accommodation (see further in Chapter 6).There also remains the view for some that if an employee is provided with a benefit with a value of £100 the employee will pay £40 of tax if she is a 40 per cent taxpayer;[19] whereas in order for the same employee to be provided with sufficient pay after tax to enable her to purchase the same benefit she would need to receive £167. This is not comparing like with like: one is pre tax and one is after tax (and NICs are ignored for simplicity), but it is a view still held.

1.67 A possibility therefore is to consider an entirely new system. In doing so it would be important to identify the principles which should guide the design of the system:

- **Who should pay the charge?** Currently tax on benefits and expenses is paid by both the employer and the employee and tax takes two forms: income tax and NICs payable at different rates and on different values according to the detailed rules. It would be simpler if all benefits and expenses were taxed the same as cash and therefore subject to Class 1 NICs. Arguably it would be even simpler if there was only one tax charge incorporating both income tax and NICs levied at the level of the employer only;
- **What should be taxed?** The simplest approach is to tax all benefits and expenses and to do so at the same rate. Any exceptions to this should be kept to a minimum and specifically stated. However, a fresh look at just what is a taxable benefit or expense would need to be carried out. We have heard on various occasions that employers and employees are caught out by the tax rules applying to something which they would not consider to be a "benefit"; for example, physiotherapy services provided for employees carrying out heavy manual labour;
- **On what value should the tax charge be applied?** Maybe if the system is to be truly neutral as to whether an employee is remunerated by cash or non-cash the value should be the grossed-up value of the benefit (in the example above £167); and
- **How should the tax charge be applied?** If the tax could all be accounted for through the payroll and RTI systems (see paragraph 5.45 onwards) there would be significant administrative simplification.

1.68 Any general review could consider the issue of designing a system that only taxes as a benefit something that really is a benefit, as mentioned at the start of this chapter. We have had a number of examples cited to us during our meetings; many revolve round the travel and subsistence rules, with accommodation whilst working at a second permanent workplace probably being the most frequent source of irritation. We will do further work in this area during the next stage of this project (see also Chapter 4).

1.69 Other such 'non benefits' range from the physiotherapy that employers have to provide through reimbursed expenses to more complex issues such as professional advice given to a management team during a major business transaction. That professional advice could be seen as personal (and there will be instances when it has a definite personal benefit, such as when shares

[19] Not a car benefit.

are being issued to the management team) but much of the advice could be around explaining business implications and consequences and should not raise questions of benefits in kind.

1.70 If the tax cost is identical regardless of the form of remuneration, salary sacrifice gives costs with no tax advantage, but disadvantages in relation to redundancy pay and other occasions where actual pay is used, such as the National Minimum Wage and redundancy payments. However, it would potentially increase the incentive for people to be self-employed.

1.71 One example of a different and potentially simpler system is the fringe benefits tax in Australia which was introduced in 1986.[20] If a more radical approach of the sort suggested above was to be contemplated in relation to the taxation of employee benefits and expenses further consideration to the experience in Australia and other fringe benefits jurisdictions would be informative.

1.72 This sort of radical change has come up in discussions but is not something which consultees have been asking for, perhaps because it is seen as too radical and unlikely to be considered by the government. We have not explored such an idea in detail at this stage, but we think it is worthy of more detailed consideration.

[20] See Annex F.

2 Possible "quick wins"

2.1 As we have gone around the country talking to people, we've been struck by the number of relatively minor things that are causing grit in the machinery. Things where a little change could make a big difference. We've listed the ideas in Table 2.A below.

2.2 Some ideas would need legislation (though secondary legislation may be possible for many); others just a change in the way HMRC does things.

2.3 With an election due in 2015, it may be difficult to find legislative space in the next two Finance Bills for substantial changes, but some uncontroversial items that each only need a line or two of legislation should be achievable. Also, many changes to the PAYE process could be implemented by secondary legislation, which is easier to do than if the changes needed to be in a Finance Bill.

2.4 Ideally we would have set a high/medium/low priority mark against these ideas but we have not had time to do the necessary work to support a proper analysis. We will discuss these ideas with HMRC and our Consultative Committee and aim to publish our annotated list in September 2013.

2.5 It is worth bearing in mind that ideas in Table 2.A are not listed in priority order. Assessing the priority level, for instance, according to impact and ease of implementation, will form an important part of the next stage of the project; we will consult stakeholders.

Table 2.A: Table of possible "quick wins"

Ref No	Area	Detail	Needs legislation?
1	Benefits	HMRC to encourage voluntary payrolling of benefits, in place of reporting benefits on forms P11D. (paragraph 5.46 & 5.47)	Yes
2	Benefits – accommodation	HMRC to review published list of employments where it is "customary" to get accommodation.[1] (paragraph 6.31)	No
3	Benefits – broadband	HMRC to allow home broadband costs to be subject to PSAs. (paragraph 5.32)	Yes
4	Benefits – cars	Allow car fleet operators to buy multi-year road fund licences. (paragraph 8.21)	No[2]
5	Benefits – car fuel	Exempt electricity for electric cars from the benefit rules. (paragraph 8.20)	Yes
6	Benefits – car fuel	Car fuel benefit should be based on what you put in your tank, not how you pay. (paragraph 8.24)	Yes
7	Benefits – car fuel	Allow reimbursement of car fuel where employee contributes by 6 July. (paragraph 8.23)	Yes

[1] http://www.hmrc.gov.uk/manuals/eimanual/eim11351.htm.

[2] But this is something that would have to be arranged in conjunction with Department for Transport.

8	Benefits – cycle schemes	Carry out a proper evaluation of the cycle schemes success and look for ways of streamlining its administration. (paragraph 8.36)	Yes
9	Benefits – long service awards	Bring the minimum length of service down to five years. (para 8.41)	Yes
10	Benefits – long service awards	Allow the exemption to apply if there has been a previous award unless that was within five years (paragraph 8.41)	Yes
11	Benefits – trivial benefits	HMRC should publish a list of benefits they consider to be trivial, presumably with limits on the amounts. (paragraph 1.59 & 8.57)	No
12	Expenses – mileage rates	Align tax and NICs treatment of mileage rates over 45p. (paragraph 8.27)	Yes
13	Expenses – mileage rates	HMRC should not require retention of fuel VAT receipts for expense claims where only a mileage rate has been claimed. (paragraph 8.28)	No
14	Expenses – subsistence rates	HMRC should give better guidance on what qualifies for subsistence expenses. (paragraph 4.24)	No
15	Expenses – subsistence rates	HMRC should reinstate the practice of having a 'friends and family' scale rate. (paragraph 4.39)	No
16	Expenses – travel and subsistence	HMRC should commit to revising and updating the booklet 490 to fit better with modern working patterns.[3] (paragraph 4.42)	No
17	Expenses – travel expenses	HMRC to publish guidance on temporary workplace rules for projects carried out in phases. (paragraph 4.17)	No
18	Expenses – travel expenses	HMRC should stop treating London as one workplace regardless of travel time. (paragraph 4.38)	No
19	Expenses – removal expenses	Why do these need to be entered in three different places on the form P11D? Once is enough. (paragraph 8.81)	No
20	Expenses – removal expenses	Remove the 5 April requirement in s274 ITEPA: change it to 'within X months of commencing new duties'. (paragraph 8.80)	Yes
21	Termination payments	HMRC to review its policy on "auto PILONS". (paragraph 7.6)	No
22	Termination payments	Simplify rules for overseas employees. (paragraph 7.15)	Yes
23	Termination payments	Improve HMRC guidance regarding the operation of the OT tax code in relation to termination payments, and the timing for issuing the P45. (paragraph 7.16)	No
24	Termination payments	Allow a single return of continuing benefits given on termination where these are provided for a set period of up to two years. (paragraph 7.17)	No
25	HMRC administration	Employers should be able to sort out straightforward employee tax issues with HMRC if the employee gives consent. (paragraph 5.25)	Yes
26	HMRC administration	Introduce a process where tax codes with fixed expense allowances are reviewed when employments change. (paragraph 5.28)	No

[3] We accept that actually producing an updated 490 would not be a quick undertaking.

27	HMRC administration	Improve communication between HMRC officers dealing with employer and employee. (paragraph 5.25)	No
28	HMRC administration	Improve guidance and design of Form P11D, for example state that you need a different form if the employee earns less than £8,500. (paragraph 5.3)	No
29	HMRC administration	Introduce facility to re-submit forms P11D and P11D(b) online. (paragraph 5.7)	No
30	HMRC administration	Add a box to the P11D to tick if the benefit is just for one year. (paragraph 5.27)	No
31	HMRC administration	Allow voluntary notification of in-year changes to benefits. (paragraph 5.13)	No
32	HMRC administration	HMRC to improve guidance on allowable expenses. (paragraph 1.62)	No
33	HMRC administration	HMRC to allow all types of expenses claims to be made on one form, or online. (paragraph 5.17)	No
34	HMRC administration	Improve web-site guidance and cross referencing, for example keep the What's New pages up to date. (paragraph 5.55)	No
35	HMRC administration	HMRC should publish a list of standard items and conditions that will always qualify for dispensations (paragraph 5.41)	No
36	HMRC administration	Allow dispensations to be made for a tax year by 6 July of the following year (the P11D deadline) (paragraph 5.43)	Yes
37	HMRC administration	HMRC should make it clear that they allow PSAs to be made for overseas employees and non-doms. (paragraph 5.35)	No
38	HMRC administration	The online dispensation process should be publicised and made available to all employers. (paragraph 5.42)	No
39	HMRC administration	Allow adjustments in relation to AMAP reimbursements to be submitted online. (paragraph 5.7)	No
40	HMRC administration	HMRC to improve guidance and awareness of dispensations and PSAs. (paragraph 5.30)	No
41	HMRC administration	HMRC to improve layout and design of Form P87 for claiming expenses. (paragraph 5.18)	No
42	HMRC administration	HMRC should reintroduce voluntary use of form P46 (car) when a car is replaced. (paragraph 5.50)	No
43	HMRC administration	Provide a link to HMRC's website guidance for new employers when they first register. (paragraph 5.55)	No

3 Statistics on employee benefits and expenses

3.1 HMRC publishes data and statistics on taxable employee benefits and expenses, and these are set out in more detail in Annex C. To assist in consideration of the issues in the following chapter of the report, this chapter summarises the data and highlights gaps in the evidence. There is good data available on benefits, but much less on expenses.

What do we know?

3.2 In 2010-11, **3.7 million people** received a taxable benefit. Tax and national insurance of **£3.36 billion** was paid on taxable benefits. HMRC processed around **4.5 million forms P11D** from **300,000** PAYE schemes in 2010-11. Fewer than 20,000 forms P9D were filed.

3.3 In 2012, HMRC estimated the total cost to employers of filling in forms P11D and P9D was £160 million.

3.4 HMRC's published data on employee benefits is based on benefits reported on forms P11D recorded on HMRC's IT systems. It does not take into account benefits and expenses on forms P9D for employees earning less than £8,500 a year, or payrolled benefits and expenses. The latter are cases where the P11D is submitted to HMRC but not recorded on the IT system. HMRC estimates that the total value of benefits not being recorded from these first two categories is approximately 5 per cent of the total of those which are recorded.

3.5 The numbers also don't include benefits and expenses that are the subject of PAYE Settlement Agreements (PSAs), where the employer agrees to pay the tax on behalf of the employee. HMRC estimates that around £1 billion, or 12 per cent of benefits by value are subject to around 40,000 PSAs each year.

3.6 HMRC has little data on tax exempt benefits. For example, some living accommodation provided to employees is exempt from tax. But we don't know how many people get tax-free accommodation, or what the value of their benefit is.

3.7 HMRC publishes an estimate for the "tax gap" (the loss of tax and NIC due to error, evasion or avoidance) due to employers, but does not say how much of this is due to employee benefits and expenses (see Table 3.A).

Table 3.A:

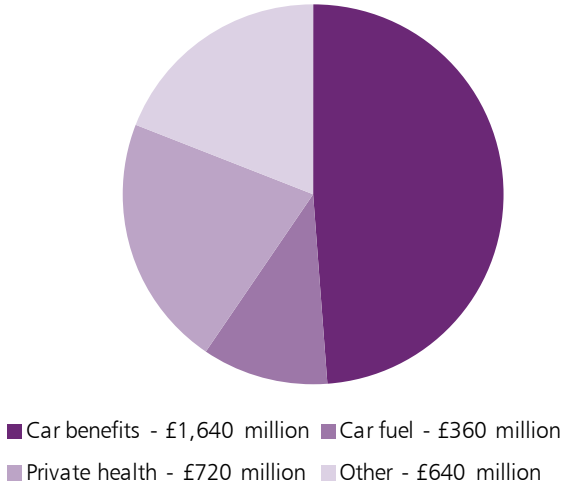
2010-11 estimated tax gap for employers (£ billion)		
	Large employers	Small and medium employers
Incorrect returns	1.9	0.5
HMRC compliance yield	0.3	0.3
% of SME employers under-declaring tax		26%[1]
Source: http://www.hmrc.gov.uk/statistics/tax-gaps.htm		

[1] This figure has been coming down – it was 40 per cent in 2006-07, 39 per cent in 2007-08 and 34 per cent in 2008-09.

3.8 The headline figures for 2010-11 are:

- 3.7 million people received taxable benefits, from around 300,000 employers;
- the value of benefits reported on forms P11D and recorded on the IT system was £7.4 billion. Allowing for PAYE Settlement Agreements and payrolled benefits brings it up to £8.8 billion;
- the tax and national insurance paid on the benefits recorded on the system was £3.36 billion, broken down into tax of £2.4 billion and NICs of £960 million; and
- 82 per cent of the total was raised by just three benefits: cars (50 per cent), car fuel (11 per cent) and private medical and dental benefits (21 per cent). See Chart 3.A.

Chart 3.A: Tax and NIC paid on benefits in 2010-11



Source: http://www.hmrc.gov.uk/statistics/tax-benefits/statistics.pdf

3.9 In 2010-11 there were 31.3 million income tax payers who paid £152 billion in income tax. Total Class 1 employee NICs liabilities were £40 billion and total Class 1 employer NICs liabilities were £57 billion.[2][3]

3.10 Benefits in kind made up around 1.4 per cent of tax and Class 1 NIC liabilities in 2010-11. This has not always been the case, and benefits were more common in the 1970s, 80s and 90s, see Annex C.

3.11 Overall, the number of employers offering taxable benefits between 2005-06 and 2011-12 has remained constant but there have been significant falls in employers offering cars (15 per cent), car fuel (33 per cent), mileage allowance (31 per cent), vans (55 per cent), subscriptions (79 per cent) and home telephones (40 per cent).

3.12 In 2010-11, 4,280,000 individual benefits were reported on forms P11D, of which around 500,000 (12 per cent) were for benefits worth less than £100 and 1,640,000 (38 per cent) were for benefits worth less than £500.

[2] HMRC figures. The total Includes Class 1, Class 1A and Class 1B NICs.

[3] The Class 1 employee and employer NICs figures are based on a 1 per cent sample of HMRC Pay As You Earn administrative data, scaled up to provide estimates of total employee population.

Expenses

3.13 Although the data on employee benefits is quite good, there is no reliable estimate of the expenses claimed by employees, or reimbursed by employers. This is because most are covered by HMRC "dispensations". These are agreements between employers and HMRC that certain expenses and benefits do not need to be reported because no tax is due on them. HMRC issued 134,000 dispensations in 2012, and 562,000 since 2008. A breakdown is in Annex C.

3.14 Any expenses reimbursed by employers that are not covered by dispensations should in theory be reported on forms P11D. The employees then make separate claims to HMRC for allowable expenses.

3.15 HMRC used to publish data on employee expenses from forms P11D, but stopped doing this in 2010. This was because they carried out a sampling exercise and found that the majority of expenses reimbursed by employers and reported to HMRC were matched by expenses claims by employees, resulting in the reported amounts being non-taxable. The total of expenses reported for 2010-11 was £1.1 billion, of which half was travel and subsistence. A breakdown is at Annex C.

3.16 In the next stage of this project we propose to carry out a detailed review of travel and subsistence expenses. As part of that review we hope to gather better data on expenses claims, perhaps by carrying out a survey of employers.

Termination payments

3.17 HMRC estimates that the total cost of the £30,000 tax exemption for termination payments was £800 million in 2012-13. If a payment qualifies for the tax exemption then the whole sum is exempt from NICs. HMRC has no estimate of the cost of this NICs exemption.

Business costs and administrative burdens

3.18 In 2012, HMRC estimated[4] that the total annual cost to businesses of providing P11D and P9 reports of benefits and expenses was £160 million. This was the twelfth biggest single tax burden on businesses.

3.19 The cost to businesses of reporting and paying Class 1A employers NIC on benefits was relatively low, £3.6 million across 370,000 businesses.

3.20 The total administrative cost to businesses of agreeing PSAs was estimated to be just £2.2 million, with 20,000 businesses affected.

3.21 There is more data on the cost to businesses of employment tax obligations in Annex C.

HMRC operating costs and customer service data

3.22 HMRC has given us some statistics for calls to its employer helpline. In the year to October 2011, 6 per cent of calls were about employee benefits and expenses.

3.23 We were also given data for hits on HMRC's website guidance for employers. In 2012-13 110,000 people visited the guidance on tax codes for benefits, and 195,000 people visited the car and fuel benefit calculator site. 193,000 people downloaded a form P87 (to claim employment expenses). 5,500 people downloaded HMRC's toolkit on expenses and benefits.

[4] Estimates provided are based on 2012 estimates from HMRC which are an update to the 2006 KPMG report referenced in Annex C.

4 Travel and subsistence expenses

4.1 Travel and subsistence is an area we are recommending as a priority for further work in the next stage of this review.

4.2 Two connected themes run through the comments received from employers about the travel and subsistence expense rules:

- firstly, many employers said that working patterns have significantly changed since the current travel and subsistence rules were introduced in 1998; and
- secondly, linked to the first item, non-deductible travel expenses are more frequently being incurred in order to meet the commercial needs of employers. Employees do not see these expenses as a benefit and do not think that they should be taxed on them. Employers are therefore expected to cover the tax and NICs on these expenses.

Background

Box 4.A: Basic tax and NIC rules for travel and subsistence expenses

Employees are entitled to relief for the full cost they are obliged to incur travelling in the performance of their duties[1] or travelling to or from a place they have to attend in the performance of their duties – as long as the journey is not ordinary commuting or private travel.[2] 'Ordinary commuting' means any travel between a permanent workplace and home, or any other place which is not a temporary workplace.

4.3 The rules[3] defining a **'temporary workplace'** were the source of most comments regarding travel expenses. A 'temporary workplace' is a place attended for the performance of a task of limited duration or for a temporary purpose. A place is not regarded as a temporary workplace, if:

- the employee's attendance is for a period of continuous work which lasts more than 24 months;
- it is reasonable to assume that it will last more than 24 months; or
- the employee will be attending that place for all or almost all of that particular employment.

4.4 For the purposes of operating this rule HMRC regards a period of continuous work to be one where the employee spends 40 per cent of their working time at that place. Even if an employee spends less than 40 per cent of their working time at a place the workplace will not be considered temporary if the employee's attendance at that place is regular and ongoing.

[1] Section 337 ITEPA 2003.
[2] Section 336 ITEPA 2003.
[3] Section 339 ITEPA 2003.

4.5 A place attended for less than 24 months, but that is attended for all or almost all of the period the employee is likely to hold the employment, is not a temporary workplace.

4.6 For the self-employed there is no formal rule but HMRC operate a less generous six month limit on what is a temporary workplace.

More than one permanent workplace

4.7 Many large employers report that they are increasingly asking some employees to split their time between more than one workplace. Typically this follows from reorganisations or rationalisations and mean the employee has to supervise dispersed teams, or cover wider areas. If an employee is not attending the additional workplace(s) for the purpose of performing a task of limited duration or for some other temporary purpose, they will have more than one permanent workplace.

4.8 One employer explained that due to takeovers and downsizing there were strong commercial reasons for asking their employees to take on responsibilities at more than one site. Universities explained that where they are setting up second campuses they generally need to ask their existing teaching staff to attend both campuses. The campuses can be significantly far apart – for instance the Midlands and London. We heard from one city council that their employees now have to work at any of the council's locations as a condition of their employment: over 400 sites.

4.9 Employers who ask employees to attend a second workplace, seem to be covering the additional travel costs. The employees, who probably spend more time travelling as a consequence of having two or more workplaces, do not see the payment of the additional travel costs as a benefit and are therefore unwilling to be taxed on them.

4.10 Employers are finding it difficult to explain why the travel expenses to the additional permanent workplaces are taxable and feel obliged to pay the tax and NICs. Employers reported that they were unsuccessful in agreeing with HMRC that the additional travel costs could be included in their PSA and were paying the expenses through the payroll on a grossed-up basis. Ultimately the employers thought that the travel expenses to the second workplace should not be taxable.

4.11 Employer provided accommodation, say in a hotel near the second permanent workplace, is a taxable benefit. Again it was questioned why this should be a taxable benefit, when the accommodation is often very basic.

The 24-month rule

4.12 We were told that increasingly projects require employees to attend a different workplace for more than 24 months, particularly in the construction industry. We were given a range of examples of projects that by definition were temporary but which had to be regarded as permanent workplaces because of the 24-month rule.[4]

4.13 The 24-month rule is having an impact on the commercial decisions made by employers. Some employers reported that the rule drives their decisions as to how long they will assign people to a project for. They might commercially require the employee to be on the project for more than 24 months but the employee will only be assigned for 24 months so that the expenses qualify. Another employee might then be assigned to the project, breaking continuity.

[4] Examples cited in OTS meetings included the London Olympic Park and the Glasgow Commonwealth games facilities – both long projects but which will definitely finish by a set time. Others were the development of a major office block or residential area.

Other employers assign people for more than 24 months and decide to take on the associated tax and NICs costs.

4.14 We were also told that HR teams do not fully understand the temporary workplace rules and often make decisions without regard to the tax consequences. By this point it can be too late to change plans and the employer ends up grossing-up the tax on the taxable travel and subsistence expenses.

4.15 Employers reported that it was unhelpful that the 24-month rule is based on what it is "reasonable" to assume. If an employee is given a temporary assignment intended to last 24 months or less but that intention changes at some point, the employer has to identify when the change in intention occurred.

4.16 They would prefer just to have a 'cut off' and for the first 24 months of a temporary assignment to qualify regardless of the intention. At the moment employees who overestimate the length of a project can lose out and those who underestimate how long the project will last may benefit from the travel expenses qualifying for the first 24 months. The point is that a fixed 24 month period would be simple and clear to operate.

4.17 Another issue that employers report is phased projects. An employee may attend a temporary work place for one phase of a project, go away and work elsewhere on a different project and then return to the first project for a later phase. They may then fall foul of the 40 per cent rule, by attending a workplace for a period of continuous work (for 40 per cent or more of their working time), for more than 24 months. It was reported that some employers have been able to agree with HMRC that for the two different phases the workplace is treated as two separate temporary workplaces. It was suggested that the rules are changed so that there is a statutory footing for such decisions.

Home workers

4.18 There are two general categories of home worker:

- employees allowed to work some time at home by their employers; and
- employees required to work at home by their employers and therefore 'home based'.

4.19 The category people fall into determines the tax treatment of their expenses. These are mainly the expenses connected with using the home as a workplace (heating, broadband etc) and the costs of travelling from the home to other workplaces.

4.20 Employers and HMRC both said that there is confusion surrounding travel expenses for home workers. The rules concerning travel do not align with those for costs of using the home as a workplace. Even if the home is treated as a workplace for claiming the costs of using the home, travel between home and the second permanent workplace may be treated as commuting.[5]

4.21 Employers reported that it is becoming more common for them to ask their employees to work from home on a regular basis for commercial reasons. As office costs increase and companies reorganise there is more pressure on desk space in offices. Home working is also linked to the increase in those working at two or more locations: as one employer put it, it is a measure of compensation to some. It seems that employers and employees are uncertain about what can be reimbursed or claimed as qualifying expenses when home working. Also employers

[5] HMRC Manual EIM32170.

reported that HMRC are unclear and inconsistent in determining whether an employees' home is a workplace for tax purposes.

4.22 The position on household expenses depends on whether the employer is reimbursing the employee. Employers can reimburse an employee tax and NICs free up to £4 per week or £18 a month where there is a home working arrangement and the employee works regularly at home under it.[6] The arrangement can be voluntary. The rules are much stricter for employees claiming a deduction for expenses that have not been reimbursed by the employer.[7] Essentially they cannot have any facilities at the employer's premises and at no time before or after the employment contract is drawn up can they have a choice between working at the employer's premises or elsewhere.

4.23 There is probably much more to unpack around home working and the complexities perceived by employers and employers. The comments we received were general but frequent – the great majority of employers in meetings allowed home working to some extent.

Subsistence

4.24 There are no separate and distinct rules about subsistence expenses (food and accommodation). It was commented that employers and employees would benefit from some clear separate rules on what type of subsistence expenses qualify.

4.25 Perceived inequalities were highlighted. For instance, an individual who is out for the day travelling for business can claim a tax deduction for a lunch that they purchase on the go, but someone who prepares a packed lunch at home to take with them can claim nothing.

4.26 Employers also gave examples of when they provide food at the office or even hotel accommodation to facilitate long working hours to complete a project. Neither the employers nor employees consider the provision of food or accommodation in these circumstances as a benefit and do not think that they should be taxed on the costs. It is accepted that working lunches are not taxable on employees where there is a free or subsidised canteen, but arguably this is unfair and costly for those employers who don't have such facilities. It is probably outdated, given the reducing numbers of 'canteens' and potentially discriminatory against smaller businesses.

4.27 With regard to accommodation we were told about the differing treatment of accommodation for employees attending a temporary workplace. If the employee is placed in a hotel, provided the employer has a dispensation covering it, there is no need to report the accommodation. If more long-term accommodation is provided such as a flat or house, the benefit has to be reported on the employee's P11D and is then included in their tax code. It is then very difficult to get the tax code changed to reflect that ultimately the provision of the accommodation is not taxable. It was commented that apportioning the accommodation costs for families so that there is only relief for the accommodation appropriate for the employee is too difficult.

4.28 Beyond the basic travel rules the legislation contains specific rules, such as the rules concerning travel between group employments and travel costs of non-domiciled employees performing duties in the UK. The HMRC manuals are clear that these two provisions only apply to accommodation required in transit rather than at the destination. Confusingly the legislation is silent on accommodation.

[6] Section 316A ITEPA 2003 and HMRC Manual EIM01472.

[7] Section 336 ITEPA 2003 and HMRC Manual EIM32760.

Benchmark scale rates

4.29 HMRC publish advisory benchmark scale rates. Rates for employees travelling for work purposes in the UK are published in the HMRC manuals and rates for travel outside the UK are available on the HMRC Internet Library. Employers can agree with HMRC under their P11D dispensation to pay scale rate payments to employees who are meeting the statutory travel rules. Scale rates were raised as an issue on several occasions for different reasons:

- the current rates, e.g. £5 for lunch or breakfast, are considered to be too low;
- employers queried why, for employees travelling within the UK, they were required to collect and retain receipts for the expenses incurred when the scale rates should be helping to streamline processes. It was pointed out that often employees buy their meals from places that don't readily provide receipts, such as burger vans;
- as per the guidance, employers are not required to carry out a sampling exercise before they apply for and are granted a dispensation that will include scale rates at or below the benchmark rates. We were told that HMRC were asking employers to carry out a sampling exercise when renewing dispensations and it seemed like mini PAYE audits were being carried out; and
- we were told that employers are wrongly assuming that expats on assignment in the UK can benefit fully from the published benchmark scale rates.

Travel and subsistence and salary sacrifice

4.30 Several recruitment agents were keen to talk to us about the use of travel and subsistence schemes in the labour provider sector. Recruitment agents who do not use the schemes believe that the use of schemes by other companies is having a very negative impact on their own businesses.

4.31 Under the schemes workers give up amounts of salary and in return receive travel and subsistence payments tax and NICs free. The travel and subsistence payments are not equal to the salary sacrificed and the impression is that the agency benefits from the majority of the tax and NICs savings – it was reported that the worker may benefit from as little as 9-11 per cent of the savings.

4.32 This enables the recruitment agencies that use the schemes to charge their clients lower fees, possibly even running with a negative margin. Agencies who are not operating schemes are therefore finding it difficult to compete and some have told us they will go out of business if they do not adopt this model.

4.33 One agency explained that they did not want to implement a scheme, but the company was coming under increasing pressure from some very large clients to implement one. A number of concerns were expressed about the schemes:

- loss of revenue to government;
- individuals who do not work the whole year and would ordinarily be entitled to a tax refund cannot claim the refund as they have not paid the tax;
- individuals lose out on entitlement to contributory benefits and also the full level of employer pension contributions they are due through auto-enrolment; and
- individuals end up being paid less than the National Minimum Wage.

4.34 The National Minimum Wage Act was amended in 2010[8] so that travel and subsistence payments can no longer count towards the amount assessed for National Minimum Wage (NMW) purposes. However, we were told that operators of schemes were still taking their workers below the NMW.

4.35 Low income groups are also concerned that if the schemes go wrong, possibly through poor implementation, it will be the worker that loses out.

Other issues

4.36 The special foreign travel rules which allow deductions beyond the basic travel rules are complicated and very subtle. For instance a deduction of the accommodation costs of employees carrying out duties abroad is only available if the cost is borne or reimbursed by the employer. The number of qualifying trips family members can make depends on the number of tax years the assignment straddles rather than the duration of the assignment. This should be reviewed at the same time as the basic travel rules.

4.37 Under the travel rules, an employee can have a permanent workplace by reference to an area. Employers and advisers told us that they found rules in connection with area workers unduly confusing and complicated – again it may be a case of the rules not keeping up with changing working patterns.

4.38 We were also told that employers had received some unhelpful decisions from HMRC with regard to workplaces in London, with some being told that all of London (within the M25 perimeter) is one workplace even though two workplaces could be one-two hours apart yet still within the London conurbation.

4.39 Since 6 April 2009 employers have no longer been able to agree a scale rate with HMRC for expenses incurred by an employee when they stay with a friend or relative when travelling on business. (The employee may claim a deduction for the actual subsistence costs incurred.) The charity and university sectors, among others, said that this was unhelpful. Encouraging employees to stay with friends and family is much more cost effective for employers than paying for hotel accommodation.

4.40 Employers expressed concern about rules that they understand and can follow being changed as a result of this review. However, some individuals we spoke to may not actually be following the current rules. A number of employers, including some large ones, still apparently use the triangular travel rules that applied before 1998.

4.41 We were told that sometimes over-zealous HMRC Inspectors assume that the wholly, exclusively and necessarily rule for general expenses applies to travel expenses when in fact the statutes only require the journey to be necessary. The statutory rules are confused with HMRC's less generous rules for its own staff. Other employers will have rules that are less generous than the statutory rules and possibly employees are not aware of the full deduction that is available.

4.42 In terms of the guidance available to employers, generally the feedback on HMRC's booklet 490 was favourable. Employers find the booklet useful. They turn to it as a reference and like the use of specific scenarios to explain how the rules work. It was suggested that the booklet could have some new examples to reflect the changes in working practices described in this chapter.

4.43 There was some confusion among employers on whether the travel of non-executive directors to attend board meetings is ordinary commuting or not.

[8] The National Minimum Wage (Amendment) (No.2) Regulations 2010.

4.44 The charity sector raised some concerns about the travel and subsistence expenses of volunteers. This may be confusion about the rules – volunteers are not employees.

Conclusions

4.45 This is clearly an area that affects a great number of employers and employees. Our discussions have highlighted a range of issues, substantiating the suspicion we had in framing this project that the travel and subsistence rules are becoming outdated.

4.46 We need to take forward a lot of issues and that process will have to include:

- whether changes can be made that do genuinely simplify the system;
- whether such changes better reflect working practices;
- how easy revised methods will be to explain and operate;
- the impact on employees;
- avoidance risks; and
- implications for the exchequer.

5 HMRC administration, including the form P11D process

Annual reporting on forms P11D and P9D

5.1 Many people we have spoken to feel that the P11D process is particularly complicated and out of date and ripe for replacement by a better, less onerous process. Payrolling of benefits seems to many people to be the future, as long as it is done on a flexible and voluntary basis. Of course introducing an alternative method of dealing with benefits does of itself risk adding to complexity. If this idea is to be pursued, as we think it should be, the practical implications will need to be carefully analysed and considered. As noted in Chapter 3, there are some 4.5 million P11Ds submitted annually at a cost to employers of some £160 million, so there is great scope for efficiency gains.

Box 5.A: Reporting benefits on forms P11D and P9D

At the end of each tax year, an employer must report benefits and expense payments that have been paid to employees during that tax year, using either a form P11D or a form P9D. A P11D is used in relation to each director and each employee who earns over £8,500 per year, and a P9D is used in relation to each employee who earns less than £8,500 per year. The employer must submit any P11Ds or P9Ds to HMRC by the 6 July following the end of the tax year, and each director or employee must also receive a copy of his form.

5.2 Feedback from our meetings indicates that the obligation to file a separate form in respect of each employee or director involves excessive administration for employers, particularly as the P11D is so complicated. Its layout and references to different types of benefits and expenses make it difficult to complete and hard for employees to understand. Employees are often confused as to why a P11D is even needed, for example in salary sacrifice schemes where, from the employees' point of view, they should not be given forms that suggest they have to pay tax on benefits which they have "bought".

5.3 Big companies tell us that they manage the process: it is something 'we just have to do'. They devote necessary resources to the work. Smaller companies find it more difficult (many will outsource the work). Those that use the HMRC guidance on completing the P11D often say it is inadequate (for example, the form does not make clear that the P11D must be filed in relation to all directors even if they earn less than £8,500) and it does not cover all types of benefits and expenses.

5.4 Particular difficulties arise when completing the section for "other" items (which contains irregular benefits that cannot be coded elsewhere), as there is no clear protocol, and employers often fail to provide HMRC with a schedule detailing the "other" benefits that they are referring to.

5.5 It is often difficult and time-consuming for an employer to decide whether to complete a P11D or a P9D in respect of a particular employee. We are told it is standard practice for many employers to assume that all employees are earning more than £8,500 and therefore automatically complete a P11D in each case. Many are of the view that the P9D is therefore effectively obsolete – although approximately 20,000 P9Ds are still submitted to HMRC each year.

5.6 If a P11D return is made for someone who is low paid, that would potentially result in unfairness for those employees who are having tax imposed on their benefits when they should have had a P9D and no tax charge on some or all of the benefits. This issue has been raised with us by a couple of organisations and we fully accept the point, though we have to note that it is not an issue HMRC have reported to us. We noted at paragraph 1.16 some instances of possible benefits that may be given to the low paid; this is clearly something that needs to be probed further to find out more about those who would actually be affected (and by how much) rather than it just being noted as a (possibly theoretical) matter of concern.

5.7 Filing of returns is often problematic, particularly for those employers who do not use specialist software. Errors by employers are often difficult to rectify as there are restrictions on the medium in which any adjustments to returns can be submitted. For example, it is not possible to resubmit a P11D or P11D(b) electronically, and any adjustments in relation to AMAP reimbursements can only be submitted to HMRC via floppy disc. Software providers have also experienced delays in HMRC agreeing their standard form for filing each year, even where it is identical to the previous year's form apart from the reference to the new tax year. This year, employers have also had difficulties making their initial P11D submission online, with the result that HMRC have had to extend the normal 6 July deadline for employers using the online service for tax year 2012-13.

5.8 Although the P11D is filed online, it is inputted into HMRC's IT system manually in a time-consuming process which lasts until October each year. There are often delays in processing P11Ds alongside any associated claims for relief (under which a tax deduction is claimed in respect of certain allowable expenses which are incurred by the employee). Despite HMRC advising employers to send the claim form together with the P11D, these forms are split and processed separately and at different times, often resulting in employees being spent tax codes reflecting their apparent benefit which are later changed by a further coding notice when the claim is processed.

5.9 'Nil' P11Ds are a particular bugbear. These often result from reimbursed expenses and are seen as a particular waste of time. One large employer in Leeds cited a demand from HMRC for full P11Ds: that meant an extra 4,000 forms. As the employer outsourced their P11D completion to an agent, that meant further fees of £44,000 at the standard £11 per form – for no extra tax.

5.10 The increasing use of salary sacrifice or flexible pay has repercussions for P11Ds. Although employees have paid for these benefits (perhaps a car) through changed pay, HMRC usually require a P11D to be submitted. That causes confusion among employees who think they are being charged twice for their benefits; it is also a potential source of coding errors.

5.11 Further practical difficulties often arise once the P11D has been processed, as the system is not sufficiently flexible to all circumstances in which a benefit may be provided. For example, one-off benefits such as relocation expenses are treated by HMRC as being paid on an ongoing basis for each subsequent year, as there is no way to indicate in the P11D that a particular benefit will not be continuing in future. A simple box on the form to indicate that a benefit is a one-off would be a great simplification.

5.12 Problems also arise for P11Ds which relate to international assignees, as the form's format and filing system do not fully cater for the issues which are relevant to these employees.

5.13 Certain employers and software providers feel that it would be useful to be able to file during the tax year voluntarily, particularly to report the commencement or cessation of a benefit or for one-off benefits (although this requires further consideration, as this may be confusing to employees who move between employers who take differing approaches). Currently, it is not possible to file the P11D on an ongoing basis during the tax year. The 6 July deadline for filing is generally felt to be helpful, particularly for smaller businesses.

Form P11D(b)

5.14 Employers are required to submit a single form P11D(b) by the 6 July following the end of the tax year in order to declare the overall amount of Class 1A NICs due on all the expenses and benefits which have been provided during that tax year. Comments from our meetings suggest that a large number of employers do not understand that they have an obligation to file one of these forms, and that many employers also do not know which items should be included in order to calculate the Class 1A NICs due.

Expenses claims

5.15 Box 5.B demonstrates how complex it can be to complete the expenses section of the form P11D:

Box 5.B: A tax adviser's typical process for reporting expenses on form P11D

- run nominal ledger reports for all relevant expense headings;
- do this for two financial years to make sure we cover the whole tax year;
- exclude any items picked up on both reports (to avoid double-counting);
- exclude any items relating to the previous or subsequent tax years;
- exclude cancelled items and inapplicable journal entries (e.g. accruals);
- adjust for any items that have been miss-posted to the wrong account;
- review all remaining items to identify those actually reportable;
- review the VAT account to pick up amounts that should be added back;
- identify which employees or directors the reportable items relate to;
- cross-check these items against expense claims and credit card statements;
- discuss with client staff the nature and purpose of certain items; and
- re-allocate certain items to the director's loan account where applicable.

Examples of practical issues faced:

- do course fees qualify as staff training or are they more in the nature of a personal benefit?
- are restaurant bills staff entertaining, business entertaining or qualifying subsistence?
- do travel expenses qualify as tax free under the temporary workplace rules?
- are expensive leaving gifts "trivial expenses" or taxable benefits?
- are mobile phone contracts in the name of the company or the individual?
- are parking expenses for company vehicles reportable or not?
- are fuel costs for company vehicles reportable if reimbursed in cash?
- when is the employee acting as an agent for certain company expenses?
- what is the position for people working at home (e.g. computers, postage, stationery)?
- do certain subscriptions/publications count as employment expenses or benefits?

Source: Christopher Field FCCA of Acumen Tax Solutions, Purley, Surrey

5.16 Employees ask for tax relief for their expenses on their self-assessment tax return or, if they do not file one, they can use a form P87. However, many employees simply send a separate letter to HMRC to claim their expenses.

5.17 Both HMRC and taxpayer representative bodies have said to us that it is unhelpful that there is not one mandated form that must be used for all types of expenses repayments. The current system for claims is more onerous for HMRC to administer and unclear for employees who wish to make a claim.

5.18 The P87 itself is unwieldy and with inadequate guidance notes and cross-references. In particular, it does not highlight to the employee what evidence he would need to be able to provide in order to support a claim. The P87 cannot be submitted online, resulting in additional administration for both employees and HMRC, and a high level of incomplete forms being submitted (as compared to online forms where a web-based support function would automatically assist with this). HMRC have indicated to us that they are aware of all of these issues and are currently reviewing the format of the form.

5.19 In recent years there has also been a growth of high volume agents which are encouraging employees to submit expense claims in return for a percentage of those claims that are settled by HMRC. This practice has resulted in increased administration for HMRC in respect of the high number of claims that they are processing, but more particularly it results in wasted time and possible penalties for employees, who too often are encouraged by the agent to file a claim when they are unable to provide sufficient supporting evidence.

Tax codes

5.20 The impact of the P11D and expenses claims on tax codes has proved to be a real concern in practice. One large employer has indicated that it can take up to a year for tax codes to be adjusted in order to reflect taxable benefits. This can cause particular difficulties for employees. Where a benefit starts being paid part-way through the year and there is a long delay in adjusting his tax code, the result can be that the employee is suddenly faced with three years' of tax being imposed at the same time in relation to that benefit.

5.21 The way that tax codes operate causes great confusion. The general belief seems to be that only specialist advisers and those working in finance teams are able to understand them. The position is even less clear for those individuals who have more than one job. Many have commented to us that there are simply too many errors in producing tax codes, resulting in upset for employees and employers feeling pressurised to help in this process. Employees typically assume that coding errors are the fault of their employer, a belief exacerbated by the wording on the coding notices.

5.22 We have been told of cases where employees have had their tax code adjusted even when they had not received any benefits at all and therefore were not subject to a P11D. In one such case the code adjustment wrongly suggested that the employee was in fact benefitting from the use of a company jet. Another example was where a business's employees were 'double charged' their salaries: the employer had changed its name and HMRC systems recorded salaries from both names. That led many employees to receive coding notices withdrawing their personal allowances (as they seemed to be getting £100,000+) and a great deal of wasted time all round getting them corrected.

5.23 Particularly for companies with larger workforces, employers simply do not have the resources available to be able to query tax codes and therefore have no choice but to use whatever code is given.

5.24 We pointed out the complexity of tax codes in the OTS Review of Pensioner Taxation.[1] In particular, we recommended a composite P2 coding notice from HMRC where people have several sources of pension or employment income. We understand HMRC is taking this proposal forward at the moment. It is clearly something that would benefit all employees.

5.25 Difficulties are exacerbated by a general failure for there to be effective communication between the employer, the employee and HMRC. When the employee queries his code HMRC often directs him back to his employer, rather than taking ownership and entering into a three-way dialogue in order to collectively resolve the issue. Some employers wanted to be able to sort out simple issues on behalf of employees, for example ringing up HMRC to ask them to issue a form P87 to allow the employee to claim expenses, or to report a benefit that needed a coding change. Others felt that was not the employer's job.

5.26 When an employee successfully claims an expenses repayment then the system changes her tax code permanently unless the employee notifies HMRC that she no longer bears this expense, resulting in a loss of revenue to the Exchequer.

5.27 There is a similar problem for one-off benefits or expenses, such as relocation costs. As we have suggested above, there should be a box on the P11D to indicate that an item is a one-off.

5.28 Similarly, fixed deductions (which are amounts of flat rate expenses which HMRC agree with relevant trade unions or other representative bodies, to cover the costs of maintaining tools or special working clothes) also present problems. They are included in the employee's tax code once they have been notified to HMRC, but sometimes remain in the code even if the employee changes employment, unless the employee specifically notifies HMRC in relation to the change.

PAYE Settlement Agreements (PSAs)

Box 5.C: PSAs

A PSA allows an employer to make one annual payment to cover all the income tax and NICs due on employees' taxable expenses or benefits which are minor or irregular, or where it is impractical to apply PAYE or to work out the value of the relevant benefit. HMRC must agree in advance which benefits or expenses can be included in the PSA for a tax year, otherwise limitations will apply to the items which can be covered by the PSA for that year. An item which is included in a PSA does not need to be put through payroll, or included in the P9D and P11D, and no Class 1A National Insurance will be due on it (as the employer pays Class 1B National Insurance as part of the PSA instead).

5.29 The feedback that we have received indicates that large employers find PSAs an extremely helpful way of simplifying the settlement and reporting of tax for employee benefits and expenses. One respondent estimated that if there was no PSA then an extra two staff would be needed for every 1,000 employees. From a commercial perspective, PSAs are particularly valuable where an employer thinks that it would be unfair for an employee to bear tax costs on a benefit or where it is too difficult to explain to an employee why there is a tax charge (for example, the costs associated with a secondment of more than two years).

5.30 Smaller businesses tend to use PSAs less frequently, often finding them expensive due to the need to gross up the tax on the benefit and/or often more of an administrative burden in having to identify which employees pay tax at different rates. We noted that there is a general

[1] https://www.gov.uk/government/publications/taxation-of-pensioners-review.

lack of awareness amongst smaller employers regarding what can go in PSA, and that this issue should be addressed as they usually have limited administrative resources and therefore could potentially benefit from reducing their filing requirements through use of PSAs. (Though of course many will use advisers to assist.)

5.31 Overall, many feel that the rules on what can be included in a PSA are too restrictive and that companies should be able to include almost any benefit or expense in a PSA. We were told that HMRC are challenging items that would make commercial sense to include in a PSA, such as pool chauffeur cars, directors' benefits and third party benefits. This may be because they are centralising the work and trying to introduce greater consistency in applying the rules for PSAs. The requirement to work out exactly which employees have what marginal tax rate is time consuming and to many should be capable of easier approximation. A further example of unnecessary burdens arise when an employer gives a group of people a small benefit that they want to PSA: it should not be necessary to allocate each item – there should be a 'block calculation' facility.

5.32 It appears that there is a particular resistance to allowing broadband costs to be included in a PSA, which is unhelpful to employers given the increasing prevalence of home working. We have been told that foreign employees and non-doms cannot be included in a PSA. Overall, it appears that HMRC has become more restrictive in its approach generally, with items included in PSAs in previous years no longer being allowed.

5.33 Many have commented that HMRC guidance is confusing and HMRC is inconsistent as regards which benefits can be included in a PSA, even though PSAs are no longer agreed locally but are dealt with at seven designated HMRC sites. Whilst some employers are faced with a rigid approach from HMRC, other employers who have (for example) discovered a benefit after the end of the tax year have been permitted to include it in a PSA for that tax year, even though it does not strictly meet the conditions. Employers regularly said that they should automatically be able to include items in a PSA up to the time they submit.

5.34 An illustration of the difficulties caused by PSA rules and procedures was given to us by one FTSE100 company. They wished to PSA some costs around international assignees who were tax-equalised (this included tax/accountancy fees). They applied in January 2013 to include such things in their 2012-13 PSA but it took HMRC over six months to agree as they had had to refer the issue repeatedly to specialists. The result was that HMRC's agreement was received too late for the company to include these items in their PSA for 2012-13, so they had to go on P11Ds with a probable need to give employees extra compensation. Yet all the company was trying to do was to pay the tax (possibly more than was strictly due) and save administrative effort all round.

5.35 We were often told of inconsistencies around whether overseas employees could be included in a PSA.

5.36 Some feel that the PSA approval process can be cumbersome, with many querying why it is necessary for an employer to go through the PSA approval process each year if it continues to provide the same benefits year on year.

Dispensations

5.37 Some expenses and benefits are eligible for a dispensation. If a dispensation is obtained, the employer will not need to report the relevant expense or benefit to HMRC or pay tax or NICs on it.

5.38 The comments that we have received indicate that some employers often do not understand what dispensations are, and in some cases think that they are a general protection which applies automatically, rather than being granted to particular employers who apply for it.

One simple solution might be to change the term "dispensation" which can cause confusion. Against this, the term is well established and understood by many.

5.39 Advisers have highlighted to us that employers often do not appreciate that unless an expense meets HMRC's criteria, it will not benefit from the dispensation and will therefore still need to be declared. Some employers mistakenly believe that their dispensation still applies years after they have expired – in one case quoted to us, a dispensation was recently still being relied upon even though the conditions under which it had been issued had ceased to apply in 1987. Many people also feel that the record keeping and evidence required in relation to dispensations is unnecessary additional administration for an employer.

5.40 HMRC appears to be inconsistent regarding what can and cannot be included in a dispensation, and unclear about what it is seeking to encourage or discourage in its policy on dispensations. Many advisers feel that too few dispensations are granted, and that HMRC do not have good enough records of which companies had been granted a dispensation. Concerns have been raised that in some cases HMRC grants a dispensation without understanding the impact, for example in relation to travel and subsistence schemes and umbrella companies. Some employers feel that HMRC is impractical in its approach, for example refusing to include non-domiciled employees in dispensations. We have also been told of excessive delays in obtaining a dispensation once it has been applied for.

5.41 In contrast to the comments in the preceding paragraph, we were told by a number of large companies that they felt that dispensations were increasingly standardised. Because of this they were of reducing benefit – but it also led the companies to suggest that HMRC could easily publish their dispensation criteria and a list of standard dispensation items.

5.42 The process for applying for a dispensation is often inadequate for the particular circumstances. Although HMRC requires the application to be made by submitting a form P11DX, this form does not allow the employer to fully disclose circumstances in which expenses are approved, and therefore a detailed letter and supporting documentation need to be submitted instead of the P11DX. There also appears to be some confusion regarding whether a dispensation can be applied for online: in some meetings we have had pleas from attendees for an on-line system with another attendee saying that they already make use of on-line applications.

5.43 There is a widely-held criticism that the date from which a dispensation can first start to apply is unduly restrictive, as it can only date back to the start of the current tax year, even though there is no legislative basis for this. A number of employers and advisers have asked why, if an employer is applying before the P11D deadline, the dispensation should not be to allowed to take effect from the beginning of the previous tax year, in order to save employers from submitting unnecessarily a year of P11Ds and corresponding claims.

5.44 A number of people have commented that it seems unnecessary to have dispensations for items which are deductible for the employee anyway. Overall, many have suggested to us that dispensations would be much more helpful if they could automatically apply in relation to standard business expenses, supported by a self-certification process by the employer. This could be facilitated by HMRC publishing clear guidance on the criteria it normally applies in agreeing dispensations.[2] Although this may be seen as increasing HMRC's risks, there is an interesting

[2] Such guidance could address any aspects of the 'benefits that aren't benefits' issue we have referred to earlier in this report. As an example, the issue of professional advice given to management/directors in the context of a business transaction sometimes is argued to give rise to a benefit, as the advice has at least in part a personal nature. There is clearly a range of advice that could be given, ranging from explanation of directors' obligations through to explaining the tax implications of the share awards they are in line for. Some undoubtedly have a private benefit component; others are wholly motivated by a need to progress the business deal and any private benefit is marginal at best. It is the sort of area where better guidance for business on what really is a benefit, in the context of 'auto dispensations' would be very helpful.

comparison made by those suggesting the process to the Senior Accounting Officer (SAO) certification requirements. Could the SAO be required to certify the self-dispensation as well?

Payrolling

5.45 Some employers enter into an arrangement to payroll benefits in kind and expenses, adding their value to the employee's other earnings when working out PAYE tax and Class 1 NICs (or Class 1A NICs only) using their usual payroll procedures.[3] These must be reported on or before the expenses or benefits are paid. However, the employer still has to send HMRC forms P11D (which must indicate which benefits have been payrolled) unless HMRC agrees otherwise.[4] Class 1A NICs arising on the payrolled benefits in kind are reported on the P11D(b) and paid in the July after the end of the relevant tax year.

5.46 The feedback that we have received indicates that some larger employers in particular would be in favour of payrolling at least some of their employees' benefits and expenses, and that this should be permitted by HMRC on a general voluntary basis. Those employers who already operate it feel that it works very well. The key is fixed amounts which change annually – medical cover, cars and vans being the obvious examples.

5.47 However, payrolling should be voluntary rather than compulsory, as it is likely to present too much of an administrative burden for small employers.[5] It is also more difficult to payroll certain items, particularly beneficial loans. So employers should be able to payroll some benefits whilst choosing to report others on forms P11D.

5.48 It will also be necessary to consider any impact that this would have in relation to the application of Class 1 NIC on employees, as lower paid employees would be hit the hardest if Class 1 NICs was automatically imposed on all payrolled items. If Class 1 NICs is not imposed then the legislation and payroll system and software will need to allow for the collection, recording and payment of Class 1A NICs on payrolled benefits instead.

Form P46 (Car)

5.49 Employers must file a form P46 (Car) if they provide an employee for the first time with a company car or withdraw one. As the form is submitted quarterly, it allows the benefit to be reported to HMRC fairly soon after it was made available to the employee, with the aim that the correct tax levels can be maintained throughout the year.

5.50 Until 2009, the form was also required to be submitted if the car was replaced, but this requirement was removed in order to help employers as employers were still obliged to report the amount of the benefit on form P11D. Nevertheless, this relaxation is felt by some to be a backwards step, as although the P46 does not need to be completed, there is now the extra administrative cost involved in collecting the additional (or reduced) tax once the P11D form has been processed. The delay can be unhelpful, particularly where there is a significant increase in the tax due on the benefit if an employee is promoted and is given a car with higher list price and emissions and also has an increased marginal tax rate.

[3] We have heard from some employers who have agreed payrolling with HMRC; others who have just started to do it unilaterally. Medical cover was the most frequently 'payrolled' item, though one or two companies were also payrolling car benefits.

[4] Again we heard of a variety of practices. One large employer eventually convinced HMRC to accept details on an excel spreadsheet; most, though seem to require normal P11D returns.

[5] We note that the advent of RTI may mean more employers are in a position to payrioll benefits due to improvements in their payroll systems necessitated by RTI.

Introduction of Real Time Information (RTI) and Universal Credit

5.51 As RTI requires employers to report PAYE information to HMRC at the time that they pay the employee, many people have raised concerns about how RTI operates alongside employee benefits and expenses. Employers do not have a clear understanding of what needs to be inserted into the RTI return, and HMRC guidance is felt to be misleading, particularly in relation to the treatment of expenses payments. One adviser commented that the guidance for employers is different to that given to the software developers.

5.52 Many are also unaware of the wider impact that the inputted information has for an employee, particularly in relation to Universal Credit and whether any employee benefits affect entitlement to Universal Credit.

5.53 For companies which voluntarily payroll certain benefits, it appears that generally the software that they use does permit those benefits to be stripped out from the RTI reporting, but there is often some confusion for employers as to how this operates, particularly in relation to salary sacrifice arrangements. The treatment of items such as beneficial loans under RTI is unclear.

5.54 HMRC has indicated in meetings with us that there are also problems with PSAs leading to incorrect income details for Universal Credit and tax credits, and self-assessment.

General practical compliance issues

5.55 Many people have expressed a wish for more practical reference material to be available to employers regarding the tax implications of paying benefits and expenses to their employees, and the associated filing requirements and opportunities for PSAs and dispensations in order to reduce this burden. Due to the complexities of this area, it was felt that more focussed guidance and cross-referencing on HMRC's website would be particularly helpful. The current guidance which is available comes in a number of different formats – from HMRC publications and booklets to guidance on the HMRC website and Statements of Practice – and is often hard to find, leaving employers unsure as to whether they have even found all relevant information.

5.56 HMRC guidance needs to be clear and simply written, aimed at the typical employer or employee, not the tax expert who will tend also to use the legislation.

HMRC work to improve employer processes

5.57 HMRC has given us a summary of work it has in progress to improve its administration of employment taxes and NICs. This is at Box 5.D below.

Box 5.D: HMRC's programme to improve the customer experience for employers

HMRC continues to invest in research to better understand the needs and behaviours of its customers and to use that knowledge to develop services that will make it easier for customers to comply with their obligations – to pay the right amount of tax at the right time. As part of this research HMRC is reviewing the processes relating to expenses and benefits in kind with a view to modernising the interactions with both individual customers and employers to reflect the changing environment in which we all operate and advancements in digital services.

HMRC recognise employers play a key role in administering personal taxes and the intrinsic link with their employees; actions taken by the employer often directly impact on individual employees in the UK.

HMRC have identified three initial priority areas relating to expenses and benefits in kind and have initiated in-depth reviews of these processes working closely with employer groups. The key areas are:

Introduction of Online Expenses and Benefits forms

HMRC have recently introduced a new online expenses and benefits suite of forms.

The full service allows employers (or their agents) to complete P9D, P11D & P11D(b) for up to 250 employees who are in receipt of expenses and benefits. The forms can be saved in part if required and can be submitted online securely. Paper copies can be printed to give to employees.

This is a new service and enhancements to the online forms will be introduced prior to 2013-14 submission.

Payrolling of Benefits in Kind

A number of employers currently choose to tax benefits in kind for their employees through the payroll but they are still required to submit a P11D at the year end. HMRC are working closely with a small number of large employers who have been payrolling benefits in kind for some time to test a new process that removes the requirement to provide forms P11D. HMRC also plan to conduct further research with wider employer groups in autumn 2013 and welcome the opportunity to work with the Office of Tax Simplification (OTS) in this area.

Expenses

HMRC recognise that there are a number of complex processes in relation to expenses. HMRC are reviewing both reimbursed and non-reimbursed expenses to identify opportunities to streamline processes.

The re-design of our processes will include making it more straightforward for customers to make claims correctly in respect of expenses. Not only will this improve their experience of dealing with HMRC but it will minimise opportunities for error or inappropriate claims, especially by high volume agents who prey on vulnerable customers. This in turn will reduce the need for HMRC to carry out as many compliance checks.

Conclusions

5.58 There is a great deal that can be changed to make employers' lives easier – and also potentially HMRC's. In summary:

- P11Ds – there are modifications that need to be made to facilitate eliminating 'nil' P11Ds and to streamline the process, but the aim should be to work towards eliminating as many of the 4.5 million annual forms as possible. RTI may help;
- PSAs – should be made far more flexible. As many businesses said 'we want to give HMRC money and potentially more than they would get with the precise procedure – what's not to like about that?' A generally more flexible procedure has potential to deliver more money more quickly to HMRC and save a lot of administrative effort all round. There will have to be some investigation of wider consequences of more items being 'PSAd' in terms of implications on individuals' tax, NIC and benefits positions;
- dispensations – there is great scope for streamlining the process. That should include HMRC publishing lists of standard dispensations (we were often told that dispensations received are increasingly standardised, so why not publish the 'rules') and the ability to 'self assess' dispensations; and
- payrolling – many would welcome this as an optional facility.

5.59 We will need to assess the impact of these ideas both on employers and employees, but also on HMRC.

6 Accommodation benefits

6.1 Two aspects of the benefit in kind rules for accommodation seem to be causing employers difficulty:

- one is the **exemption** that takes employees out of the accommodation benefit in kind charge; and
- the other is actually **calculating the charge** when the charge is in play.

6.2 Currently around 30,000 employees are provided with taxable living accommodation by their employers.[1] There is no data available on how many people receive tax-exempt living accommodation.

Exemption

6.3 There is no tax charge on living accommodation provided to an employee if it is necessary for the proper performance of the employee's duties that the employee should reside in it. There is also no charge if it is provided for the better performance of the duties of the employment and the employment is one of the kinds of employment in the case of which it is **customary** for the employer to provide living accommodation for employees.[2] An exemption applies to accommodation provided as a result of a security threat to the employee, but this did not come up as an issue during our review.[3]

6.4 There is also a non-statutory form of 'grandfathering'. It was a practical measure introduced when the current living accommodation legislation started from 6 April 1977. If a post was exempt as representative accommodation under the pre-1977 rules then, if the post remains unchanged, it remains eligible as representative accommodation and exempt now, even if someone else now hold the position.[4]

6.5 HMRC publishes a list of occupations where it is customary to get accommodation, but this does not appear to be widely known – see Box 6.A.

[1] http://www.hmrc.gov.uk/statistics/tax-benefits/statistics.pdf.
[2] Section 99 ITEPA 2003.
[3] Section 100 ITEPA 2003.
[4] HMRC Manual EIM11336.

Box 6.A: HMRC list of classes of employee who get tax free living accommodation

- 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.

Source: http://www.hmrc.gov.uk/manuals/eimanual/eim11351.htm

6.6 The onus is on employers to demonstrate that a role meets the better performance and customary tests, where HMRC have not already agreed that the role meets the tests. They have to demonstrate that the tests are not just met by their own employees, but are met by that class of employee, gathering evidence that it is normal for employees in similar roles employed by other employers to be provided with living accommodation.[5] Employers find this onerous and costly.

6.7 While it may become more common for certain classes of employees to receive accommodation, for others it may be becoming less customary. Employers may be choosing to stop providing living accommodation, but also due to social trends more employees may be choosing to source their own accommodation. We were told that increasingly employees of large estates who traditionally were provided with living accommodation are choosing to find their own accommodation. For instance they may have a working spouse and decide that that they would prefer to buy a property rather than depend on a 'tied cottage' or indeed simply want to buy their own property anyway. With increasing mobility and longevity it is nowadays much rarer for employees on estates to be tied to living accommodation when they retire. Instead, many prefer a compensation package that includes increased pension provision, rather than the provision of accommodation, as that will enable them to move to nearer to their children and grandchildren (less likely to work on the estate than, say, 50 years ago) when they retire. The consequence of these changes is that it is becoming more difficult to demonstrate that it is normal practice to provide living accommodation for a class of employee.

6.8 Another problem with the customary test is that it distinguishes between employer provided board and lodging and employer provided living accommodation. (Living accommodation allows for independent habitation – the employee has access to cooking facilities etc.). When assessing whether it is the norm for employees in a similar role to receive living accommodation

[5] HMRC Manual EIM11347.

for the purposes of the exemption, those provided with board and lodging do not count[6]. In sectors like hospitality, employees within classes such as waiters or kitchen porters will be provided with a mix of board and lodgings and living accommodation.

6.9 Examples of perceived unfairness in the customary test were provided by employers and advisers. For instance it is considered customary for a pub manager/landlord to be provided with accommodation, but not for their deputy. It was also commented that highly paid employees such as university vice chancellors fall within the customary exemption, but often low paid employees such as sheltered housing wardens and care workers do not.

6.10 Hotels require a minimum number of staff to be on site over night for safety, but the representatives from the sector reported that decisions from HMRC as to how many people are required to stay overnight and are therefore exempt are inconsistent. We were also told that independent schools are receiving inconsistent decisions from HMRC as to when a role is exempt from the accommodation charge, with HMRC making a distinction with remote schools in the country and schools in town centres.

6.11 We were told about issues for hotel employees who need to live on site, perhaps because the hotel is in an isolated location. Travelling to the hotel does not form part of the duties of the employment and the provision of the accommodation fails the better performance test.

6.12 The charity sector is particularly concerned about and interested in the rules for accommodation. Often charities have strong reasons for housing employees in certain charity owned accommodation. For instance the property may need to be occupied for security reasons or to prevent the property from becoming dilapidated. However, HMRC do not agree that the employee meets the tests for the exemption to apply in these circumstances.

6.13 We were also told that HMRC do not accept that the exemption applies when employees are provided with accommodation because they are required to be on site as part of a disaster response team. Insurers of valuable artworks may insist that there is always someone in the vicinity to recover the artwork in the event of fire etc. The employees may even participate in fire drills with the fire service.

6.14 The rural sector has had its fair share of debates with HMRC as to what roles the exemption can apply. Some of these debates have been about categorisation – can someone be called an estate worker or do they have to be given a specific role such as forester? This has then been followed with debate on whether it is customary for that role to be provided with accommodation. Roles that have been the sources of debate include; ghillies and game keepers, workers on fish farms, nursery foremen[7] and possibly more marginal roles such as curators of major houses or clerks of works.

6.15 Non-taxation legislation has had an impact on the application of the exemption. Changes to employment law (the National Minimum Wage (NMW) and the Working Time Directive) have resulted in changes of practice that have resulted in resident caretakers and resident wardens of sheltered housing schemes no longer being on call outside normal working hours. Subsequently HMRC no longer automatically accept that accommodation provided to caretakers or wardens is necessary for the proper performance of the employee's duties and a tax charge can arise on the provision of on-site accommodation.[8]

[6] HMRC Manual EIM11348.
[7] See Vertigan v Brady 60TC624.
[8] HMRC Manual EIM11342.

6.16 The hotel sector explained that they have to consider the NMW when providing employees with taxable living accommodation. There is a maximum amount that can be offset for employer provided accommodation when calculating the NMW. Accommodation in excess of the offset is then often included in a PAYE settlement agreement rather than taxed on the employee through P11D reporting. A further consideration for the employer is the VAT treatment of the supply of the accommodation, which has its own complications.

6.17 The provision of accommodation to hotel staff, care workers and so on raises the question again of when is a benefit really a benefit, as discussed in Chapter 1. The accommodation may be a benefit under the tax rules, but whether it is perceived as a benefit by the employee or anyone else is subjective and may depend on the quality and location of the accommodation.

6.18 We were told about two further limitations of the current living accommodation exemption. Firstly, commonly in the farming sector, a farmhouse may be owned by the family company. The exemption does not apply when the employee owns 5 per cent or more of the company. A taxable benefit arises. Ordinarily it would be considered customary for a farmer to live in the farmhouse.

6.19 Secondly the living accommodation exemptions do not appear to flow through to the disguised remuneration rules. The disguised remuneration rules are relevant when a third party is involved in providing an employee benefit. This can happen where a country estate is concerned and a trust/company owns the property but the employment is with an individual.

Calculating the benefit in kind

6.20 The taxable value of the benefit when the employer accommodates an employee in employer owned accommodation depends on a number of factors:[9]

- the year the property was first made available;
- whether the employer has held the property for more than six years;
- whether the property cost plus improvement amounts is more than £75,000;
- the rateable value of the property in 1973; and
- the number of employees occupying the property.

6.21 As one adviser put it, this means you could have four employees each living in a separate flat in the same block and each one will have a different benefit in kind depending on whether the flat is owned by the employer or not, when the flat was bought and whether the employer has paid for improvements on the flat. Ideally the rules for calculating the benefit should yield the same value for all four employees.

6.22 An example of an anomaly that the current rules produce is the benefit in kind that can arise if a property has been held for at least six years by the time the employee occupies it. In these circumstances the "cost " of the property for calculating the benefit is deemed to be the market value of the property at that time, but only if the original cost, plus improvements, is over £75,000. There could be two employees about to occupy two properties with similar current market values of £250,000 each, both of which have been held for the last six years. The first was purchased many years ago for £25,000 and has been improved at a cost of £30,000; the second was purchased more recently for £190,000 with no improvement expenditure yet incurred. In the first case the "market value" rule will not apply and the benefit will be calculated

[9] Sections103-110 ITEPA 2003.

based only on the "annual value" (i.e. the rateable value or an estimate thereof). But in the second case the benefit will be based on the sum of the annual value plus an additional charge which is calculated based on the £250,000 market value. This seems a strange result given that each employee occupies a property worth a similar amount.

6.23 There is a further difficulty with the six year rule. Where an employer has held a property for many years the history around cost and improvements can become uncertain – in which case it can become very difficult to establish whether the £75,000 threshold is exceeded in the first place.

6.24 Employers think the £75,000 threshold is hopelessly out of date. It was last updated in 1983 and at today's values would be around £477,000.[10] House price inflation has changed the charge for properties costing more than £75,000 from one originally targeted at higher paid employees to one that might be almost universal. Another result of the threshold not keeping up with inflation is that a charge can arise that is vastly greater than a charge on the open market rent.

6.25 It was frequently commented that the benefit calculated for employer owned accommodation can be either much lower or higher than the market rent for the property. For instance a university mentioned that it was accommodating an employee in a property purchased for £1 million. The taxable benefit was significantly higher than the market rental value.

6.26 We were told of employers who had sold properties occupied by employees and then rented the properties instead. In these instances the rents paid by the employers, and therefore the taxable benefits, are significantly higher than the taxable benefits when the employers owned the properties. It was very difficult to explain to the employees why their tax liabilities had increased.

6.27 People find it difficult to determine the annual value used for calculating all or part of accommodation benefit. For properties in England and Wales the 1973 gross rating value is used, in Northern Ireland the 1976 gross rating and for Scotland 100/270ths of the 1985 gross rating value. For properties with no annual value the District Valuer has to provide a value.[11]

6.28 Employees of charities and other organisations that have held properties for a long time often benefit from the 1973 rateable value being used for the benefit in kind. The taxable benefit is often much lower than the current market rental value. In these circumstances employers and employees would be concerned about a change in the calculation rules.

6.29 It was pointed out that some accommodation benefits are so low that the administration required to report the benefit and collect the tax is disproportionate. It was suggested that the accommodation benefit charge should only need to be reported and taxed above a threshold.

6.30 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 which illustrates the need for the legislation to be revisited and amended to ensure it is self-consistent as written, rather than reliant on an HMRC relaxation.

[10] Nationwide house price calculator for UK property, April 1983 – July 2013.

[11] HMRC Manual EIM11434.

Conclusions

6.31 Based on the anecdotal evidence gathered it seems that it is time to review the tests for the accommodation exemption. A lot has changed since 1977 when the current rules were first introduced. If the list of roles already accepted as customary were to be reviewed and expanded and the principles of the tests updated to reflect 21st century working practices the non-statutory grandfathering provision could be removed. Employees could just rely on clear statutory exemptions.

6.32 The calculation of the benefit, for those who are charged is outdated and anomalous. Logic would suggest it should be based on the current market value of the property but that has obvious practical issues as well as significant transitional impacts that need to be evaluated.

7 Termination payments

7.1 The feedback from our meetings has been that, for the majority of people, the taxation of termination payments is not a key concern but it was regularly reported as an area of some difficulty. Only a small group felt that it should be top of the agenda for simplification.

Box 7.A: Termination payments: an outline

Payments on the termination of an employment are free of income tax, provided they are not made under the employment contract, for example as a 'payment in lieu of notice' (PILON). There are many other exemptions (e.g. around foreign service and death) and practices (e.g. for payments around retirement date) which affect this seemingly simple but deceptively involved rule. A key point though is that a payment that qualifies for the £30,000 income tax exemption is free of NICs, whatever its amount.

For a detailed explanation of the tax regime for termination payments, see Annex G.

Misconceptions and lack of awareness

7.2 There is a lack of awareness – amongst both large and small employers and employees – about how the regime works in practice, and a very common misconception that the first £30,000 of any termination payment is automatically tax-free. A number of advisers and other service providers such as payroll specialists have expressed particular concern that problems often arise because employers' HR teams have agreed a termination package without fully understanding the tax implications for the employee and employer. Problems can be exacerbated over time as often an employer uses the same form of compromise agreement each time that an employee leaves, and only realises the tax impact further down the line.

Different treatment depending upon the wording of the employment contract

7.3 Where difficulties arise, it is normally in relation to higher-end payments, particularly in relation to payments in lieu of notice (PILONs). In the feedback from our meetings, the main concern has been that the tax treatment of a departing employee's package is often wholly dependent upon the provisions of his employment contract, as follows:

- employees who have express provisions for a PILON in their contract will be subject to income tax and NICs on the whole of their payment (on the basis that it is taxable as earnings because it is paid in accordance with the contract); whereas
- employees who have no such provision in their contract are more likely to be taxed under section 401 ITEPA,[1] and benefit from the associated £30,000 exemption and

[1] Income Tax (Earnings and Pensions) Act 2003.

completely NICs-free treatment (on the basis that the amount paid is closer to a damages payment, and therefore is not earnings).

7.4 This distinction is unfair when the employees rarely have any control over the provisions in their contracts. Well-advised employers are more able to structure their arrangements in a tax effective way, and for their employees to benefit from this.

7.5 There is a strong feeling that this inequality of treatment needs to be addressed and that the tax treatment should not be dependent upon the wording of the employee's contract.

Auto-PILONs

7.6 HMRC's policy in relation to "auto-PILONs" has been criticised, as the policy imposes additional burdens on employers to demonstrate that there is a "critical assessment" procedure in relation to the making of PILONs which are not expressly included in the employment contract. Some advisers have questioned HMRC's grounds for imposing this policy, when there is no legislative or case-law basis for doing so. For more details on "auto-PILONs", see Annex G.

The £30,000 exemption

7.7 We have been told (not least by HMRC) of employers unaware of the different income tax and NICs treatment of termination payments which fall under section 401 (under which the payments are entirely NICs-free, but only the first £30,000 is free of income tax). In practice, some mistakenly pay NICs on the excess over £30,000.

7.8 Many employers have difficulty over applying the rules surrounding the £30,000 exemption and the extent to which it can be available depending upon the particular circumstances. For example, if an individual is employed by two successive employers who are associated with each other, there is only one £30,000 exemption available to him in relation to all termination payments from those two employers.

7.9 The level of the £30,000 exemption itself has been queried, as it has not been increased since 1988 and therefore appears out of date. At today's prices, it should be £71,000.[2]

7.10 Some employers and advisers are in favour of an increase to the value exemption, and others have suggested that it could, for example, be linked to length of service in order to give it greater meaning and give more recognition to the contribution that the employee has made to the business. Others feel that the exemption should be extended in full, taking the view that there is no need for the taxation of PILONs at all – whether or not they are in the employment contract – as this payment represents a payment for loss of office.

7.11 One suggestion was for a lower limit which would apply to any payment on loss of employment. However, many people have raised with us the idea that a significant increase in the £30,000 exemption could be linked to imposing NICs above the limit. These are policy issues that are beyond the remit of this review.

7.12 However, one thing that could be done would be for HMRC to issue clearer guidance on what qualifies for exemption.

Legislation and guidance

7.13 We have received some comments that the wording of section 401 and its interaction with the legislation which taxes general earnings should be revisited. The definition of "earnings" is

[2] The £30,000 figure was last changed in April 1988 when the retail price index was 417.4. In May 2013 it was 986.3.

interpreted to have such a wide meaning that the majority of termination payments are taxed in full as "earnings" instead of being able to benefit from the £30,000 exemption under section 401. Certain parts of section 401 are felt to be redundant.

7.14 Greater clarity is also needed regarding the ability to rely on certain exceptions from the tax charge under the legislation (such as the exception for disability payments and for certain legal costs). Where a termination payment is made by a third party, it is also not sufficiently clear how the "disguised remuneration" legislation applies in these circumstances, and whether or not an exemption may be available to termination payments under this legislation.

7.15 The operation of the current regime in the context of internationally mobile employees is also felt to be unnecessarily complex and in need of revision and clarification, particularly as it increasingly common for employees to have periods of foreign service.

7.16 Many employers are also unclear regarding the operation of the OT tax code in relation to termination payments, and the timing for issuing the P45 in conjunction with this.

7.17 A particular source of irritation for a small number of employers is being caught out by the tax charges on post-termination benefits and the reporting requirements in relation to these. They find the requirements unduly burdensome for what are often small amounts. In many cases the continuing benefit is for a set period (typically a further year of medical cover, or simply the balance of existing cover) which goes into the next tax year. They would like to be able to make a single return to cover such items and only have to make regular returns when the benefit is being continued indefinitely.

HMRC support

7.18 Employers and their advisers who approach HMRC for guidance or clearance in relation to the tax treatment of a particular termination package tend to find HMRC slow to respond. In addition, the responses that they receive from HMRC are often strange or inconsistent, or simply not commercial. One comment has been that HMRC challenge payments made to people in their late 50s or early 60s, which is becoming increasingly relevant given the increasing age of retirement. And sometimes people leaving a company under a cloud are described as "retiring" to save face all round.

7.19 Given the complexities in this area, a number of people have expressed the wish for a more centralised and publicised clearance centre at HMRC in relation to termination payments generally, supported by a larger pool of HMRC specialists (as opposed to the existing clearance process that is available only in relation to redundancy payments – see Annex G for further details).

Conclusion

7.20 Although the regime for taxing termination payments only raises difficulties for a few people in particular circumstances, there is clearly some scope for simplifying it to streamline administration.

7.21 Given that the £30,000 limit under section 401 was last raised in 1988, the Government may wish to consider increasing the level at which this is set. A disadvantage would be that this would of itself result in some further complexity whilst employers and their advisers got used to the change, though as a one-off increase in a well-known figure, this difficulty would probably be minimal. It would also result in a loss of income to the Exchequer, although it has been suggested to us that in these circumstances this could be addressed, for example, by aligning the income tax and NICs treatment so that payments which exceeded the new threshold are subject to both tax and NICs (therefore also resulting in additional simplification).

7.22 Increasing the £30,000 limit would arguably benefit the well-paid most, allowing them to be paid a higher value on termination tax-free. However, it could also benefit businesses. In practice, employers often compensate their leavers for their net loss and are therefore forced to "gross-up" the amount of the termination payment which is not tax-free, resulting in additional cost to the employer. In practical terms, an increase to the threshold could therefore mean that a termination payment would cost the employer less money. Notwithstanding this, it appears that employers have mixed views on this, as some suggest that an increase to the threshold could well make their negotiation position with a departing employee more difficult.

7.23 We think the whole policy behind the exemption has become unclear, and the Government should carry out a policy review of what it wants to tax and what it wants to exempt in the area of termination payments. What is the policy objective when someone loses their job – and is the tax system supporting that objective?

8 Other issues

8.1 In addition to the four main areas of complexity we have listed above, we received lots of comments on other areas. This chapter lists them.

Reliefs and exemptions

8.2 As a general comment, there are too many special cases and exemptions from the benefit rules. Some seem out of date; others hedged around with conditions. Both situations make them less effective than they should be in delivering what should be one their key functions – simplifying the system for users. Simplification would therefore suggest a programme of modernisation, uprating or (for the ineffective) surgery.

8.3 The OTS carried out an initial review of all tax reliefs in 2010-11 and, following a detailed study of 155 reliefs,[1] made recommendations to abolish over 40, including some in the employment area. Many, of course, remain, including some that the OTS recommended for abolition. Examples include the tax free provision of taxis for staff after 9pm, and tax free coal to miners and their families.

Out of date tax thresholds

8.4 There are a number of numerical thresholds and ceilings that have stayed the same for a long time. The OTS carried out a review of tax thresholds in 2012,[2] and suggested that the Government reviews all tax thresholds at least every 8-10 years.

8.5 There were regular calls for increases in thresholds during our meetings. Most people did not want annual uprating, because of the administrative difficulties this would create in keeping track of small changes. Instead, there was a preference for periodic changes 'when it was worth it'. All accept that increasing thresholds means revenue loss, but if a threshold is to be meaningful, it should be kept at a sensible level. If this is not possible it would be better to abolish it to save the administrative burden of monitoring to no useful effect (see comments below on the £8,500 limit).

8.6 In Table 8.A we list all the thresholds and ceilings in the benefits and expenses area unchanged for ten years or more.

[1] Review of tax reliefs, Final report, Office of Tax Simplification, March 2011 (link: https://www.gov.uk/government/publications/tax-reliefs-review).
[2] Available at: https://www.gov.uk/government/publications/tax-complexity-project.

Table 8.A: Table of numerical thresholds over 10 years old

Description	Statutory reference	Amount £	Last updated
Employee benefits threshold	S217(1)	8,500	1979
Beneficial loans, limit for advances for expenses	S179(2)(a)	1,000	1979
Living accommodation, expensive property threshold	S103(1)(a)	75,000	1983
Termination payments, tax free amount	S403(1)	30,000	1988
Relocation expenses, maximum tax free amount	S287(1)	8,000	1993
Car benefit, minimum value for classic car	S147(1)(b)	15,000	1994
Car benefit, maximum deduction for employee capital contribution	S132(3)(b)	5,000	1994
Car benefit, minimum cost of an accessory fitted after the initial supply	S126(3)(d)	100	1994
Entertaining expenses, maximum annual amount of gifts	S358(3)(b)	50	2001
Approved mileage payments, over 10,000 miles	S231(2)	0.25	2002
Approved mileage payments, motor cycles	S231(2)	0.24	2002
Approved mileage payments, bicycles	S231(2)	0.2	2002
Approved mileage payments, passenger rate	S234(1)	0.05	2002
Overnight expenses limit, UK	S241(3)(a)	5	2003
Overnight expenses limit, overseas	S241(3)(b)	10	2003
Staff suggestion schemes, maximum tax free incentive award	S322(1)	25	2003
Staff suggestion schemes, maximum tax free financial award	S322(4)	5,000	2003
Long service awards, maximum tax free amount per year of service	S323(2)	50	2003
Entertaining, small gifts from third parties, annual tax free limit	S324(6)	250	2003
Annual staff parties, maximum tax free cost per head	S264(2)	150	2003
All statutory references are to ITEPA 2003			

The £8,500 threshold

8.7 The main treatment of this issue is in Chapter 1 but some summary comments are given here for completeness.

8.8 At almost every meeting we held, the subject of the £8,500 'higher paid' threshold came up in the discussions. Few employers make use of it; few actually monitor it. Most see it as an anachronism and the great majority of people saw it as something that needed to be abolished as being redundant. The minority view was that it should be increased significantly, with some suggesting it went up to average earnings and others suggesting that it should be tied to the higher rate income tax threshold (with the implication that some benefits at least would be only taxed to higher rate tax, in some peoples' minds).

Benefits

Beneficial loans

8.9 Beneficial loans are still given in a variety of situations. The most frequent seems to be, as might be expected, season ticket loans. That led to suggestions at some meetings that a simplification would be to give an automatic exemption for season ticket loans. This may well be worth exploring, though there are clear policy issues involved. Such investigation might assess

whether the de minimis limit (currently £5,000 but increasing to £10,000 from 6 April 2014) could be abolished in exchange.

8.10 For many overseas companies the concept of taxing cheap loans does not exist in their domestic tax legislation so they find it very difficult to understand the UK rules. Consequently, we have been told that the reports that many UK employers receive from group members in other countries on this matter are often no better than guesswork.

8.11 One compliance manager for a multinational bank told us he thought the official rate of interest was artificially high, bringing more loans than necessary into charge. This increases burdens for both business and HMRC.

8.12 The rules don't match CT deduction rules and there is often a timing mismatch with company accounts.

8.13 Beneficial loan rules are difficult to explain to employees and impractical. One bank we spoke to finds tracking interest rate changes administratively burdensome, though this has of course been much less of a problem of late. There is often an inadvertent tax and NICs charge on the write off of a loan because the employer wasn't aware it had been written off.

8.14 People welcomed the pending increase in the de minimis loan from £5,000 to £10,000.

Cars and car fuel

8.15 As a general observation, we were told that provision of company cars was declining, though it is clearly still a regular benefit. Typically provision is via choice rather than it being automatic at set levels of seniority.

8.16 Overall, people manage to cope with the detailed rules for car benefits, usually by means of dedicated software packages. However the constant changing of the CO2 bands is an irritation, mainly because of the all-too-frequent errors introduced into employees' tax codes. As some employers commented, it seems that errors are bound to happen with delays in 'catching up' changes.

8.17 The most-frequently cited problem around car benefits was when companies hired a car for an employee. This may be for a particular task and often would be for a week or series of weeks because of hire company conditions. That means the car is hired for weekends and questions of private benefit regularly arise. The plea from employers was for a sensible 'de minimis' rule to ensure that such hires do not run into car benefit charges. (Some people suggested pool cars can cause similar issues.)

8.18 One suggestion was for HMRC to use technology better. If the HMRC system interacted with the DVLA's, or a suitable database (as all garage and insurance companies computers do), then from the registration number and make and model of vehicle the correct benefit in kind could be calculated.

8.19 The PAYE code number could then be adjusted, effectively payrolling the benefit without technical input from the employer. This in turn would mean that it would be possible to reduce the entries on the P11D. These entries could be replaced by a tick box notifying compliance, or a supplementary form if additional information was to be provided, dealt with by the year end questionnaire within RTI, all on screen.

8.20 Electric cars should not give rise to a benefit when they are recharged. One large employer told us that they have a charging point on the premises, but it can only be used for company cars. There would be tax issues if people used the point to charge up their private cars.

8.21 We talked to one major company's car fleet manager, to gain further insight into the practical issues involved in managing thousands of cars. One of his significant administrative burdens revolves round paying the annual road tax and obtaining and distributing the tax disc. He made a plea that he should be able to buy licences for new cars for three or four years at a time.[3] He also questioned the need for the tax disc at all: with number plate recognition technology, isn't it possible to work towards its abolition?

8.22 A general issue raised with us a number of times is that in this day and age, many employers outsource all aspects of their company car fleet. They are therefore dependent on third parties for all the data used to make returns to HMRC of car benefits. Yet if errors arise, they (the employers) will be penalised by HMRC. Perhaps this is inevitable given the way the tax system operates (and is in some ways consistent with using an agent for compliance) but we note it as a point that may be worth exploring in terms of 'reasonable excuse'.

Car fuel

8.23 Provision of private fuel is well understood to be expensive. Thus employers who provide it are usually focused on facilitating reimbursement by the employee as the fuel scale charge is unnecessarily penal for someone who uses a very small amount of private fuel and is also at odds with environmental policy. Where the fuel scale charge is in play there is no incentive to minimise private miles. The requirement to reimburse all car fuel expenses in year is not always practicable and many called for the requirement to be in terms of reimbursement by 6 July after the year end.

8.24 The treatment of company provided fuel by way of fuel card differs, dependent on whether the employee stipulates that he is acting on behalf of the employer and this is accepted by the garage attendant; or the employee goes to pay at a pump and inserts the employer fuel card before fuelling. This procedure is derided, widely ignored and seen as impractical. One employer told us they give their staff a laminated sheet with the 'script' on it but they think staff generally ignore it. More than one employer commented that this procedure is outdated with 'pay at pump' technology.

Mileage rates

8.25 Some employers thought that the current AMAP rates are too low. They are choosing to pay above the rates and reporting the excess payments. One employer said that they would like to simply process the excess payments through the payroll, subjecting them to PAYE and NICs rather than reporting the excess payments on form P11D.

8.26 People also thought the 10,000 mile limit for mileage claims for the use of an employee's own car was too low. It was suggested in a couple of meetings that more employees use their own cars for business and are more likely to exceed this limit.

8.27 One person suggested aligning tax and NIC treatment of mileage payments reimbursed at a rate above 45p. A higher rate for van mileage was also suggested in a couple of meetings.

8.28 Another suggestion was that HMRC should not require retention of fuel VAT receipts for expense claims where only a mileage rate has been claimed. This does seem an unnecessary burden.

[3] Although such a procedure would lose government the periodic 'uprating' of the road tax, there would be useful compensation in the up-front payment of the tax for a number of years. The annual insurance check would be lost, but if this procedure were made available only to businesses that provided other assurances, it would seem to be possible. This seems to us to be worth exploring further and with the Department for Transport and may be a 'quick win'.

8.29 Since 2002-03 employees have only been allowed to claim a deduction for use of their own vehicle using the Approved Mileage Allowance Payments (AMAP) rates (45p/25p per mile). However, some individuals are not aware of this and are still submitting claims to HMRC for deductions using the actual running costs of the vehicle. HMRC tell us they should reject these claims, though interestingly that was not mentioned in any of our meetings with employers.

8.30 Some low paid people are confused about how to treat mileage payments for the purposes of Universal Credit.

Childcare vouchers

8.31 We heard from two small companies that they would like to be able to pay the childcare provider direct without having to institute a voucher scheme.

8.32 The rules for taxing high earners are seen as overly complex. The earnings assessment is difficult. We were told on occasions that the calculations were 'not worth it' in terms of the employer's efforts.

Credit cards

8.33 There is often confusion about tax and company credit cards, mainly around income tax and NIC differences.

Cycle to work schemes

8.34 These schemes provoked a lot of comments. They seem to be widespread but many employers told us that although they offered the scheme, few employees actually took up the offer. We heard from some employers that they felt 'bounced' into what had proved to be an administratively burdensome scheme by government publicity that had led a few employees to demand its introduction; but government had not given proper consideration to how the schemes would run in practice.

8.35 We asked for examples of problem areas. Suggestions included:

- the £1,000 limit;
- the 50 per cent commuting requirement (seen as unenforceable);
- transferring the bike at the end of the period (presumably when guideline figures do not help for some reasons); and
- VAT calculations.

8.36 Overall, it seems to us that it would be useful to carry out a proper evaluation of the scheme's success and look for ways of streamlining its administration.

Late night taxis

8.37 The OTS reported in its Review of Tax Reliefs that the rules were too cumbersome, subjective and impractical. We recommended their abolition but the Government was persuaded through consultation responses to retain the relief.

8.38 From comments received at our meetings, it seems to us that our original recommendation remains correct. Although that recommendation was portrayed as 'banning' late night taxis for staff, our point was that the relief is very limited and does not help those that many believe it should do. Outside London it was often seen as irrelevant (as far more people drove to work). Generally, it was of no use to employers whose staff regularly work odd hours (for example in

TV and radio where people had to get to work before public transport was available; or in sectors such as hospitality and retail where staff go home late). In both cases they would not qualify for relief.[4]

8.39 It is often hard to say whether someone could have used public transport. Some people suggested making the rules commence an hour later, at 10pm, but only allowing a set number of claims a year, to make monitoring the process easier. Even with these modifications, there would still be an administrative burden in monitoring usage of the relief. Hence we repeat our 2011 view that the relief should be abolished as poorly targeted and administratively complex.

Long service awards

8.40 The 20 year minimum for tax exempt long service awards is too long and not in line with current employment practice. In many industries, five years is seen as 'long service'. Similarly, many wanted to give awards more regularly than the rule allows.

8.41 The most frequent request was for a reduction to five years to be more realistic in today's workplace. Some also wanted to give vouchers instead of the tangible 'gold watch'. The '10 year interval' rule was also seen as a source of unfairness: an award after 15 years (not qualifying for the exemption) would disqualify an otherwise-qualifying award after 20 years.

8.42 This exemption may be a prime candidate for uprating to meet modern requirements, or abolition.

Personal computers used for work

8.43 Some people suggested a simplified tax regime on voluntary business use of personal computers could be considered, including the move towards businesses adopting Bring Your Own Devices (BYOD) to work strategies. (See also under 'use of assets' below).

Private health

8.44 Private medical cover is widely given, often for all staff though more usually for a more limited group. With the amounts involved being set for a year, this is a prime candidate for payrolling.

8.45 Some employers reported confusion among employees with salary sacrifice: employees saw the charge on their P11D and thought they were being double-charged for the benefit.

8.46 One employer said that the allocation of global policies can be difficult.

Salary sacrifice

8.47 We heard about a considerable variety of salary sacrifice and flexible pay arrangements. People thought that the Government was not clear about whether it supported salary sacrifice schemes or not. They seemed to endorse salary sacrifice in some areas – pension contributions and cycle schemes – but not in others.

8.48 Salary sacrifice schemes are often difficult to explain to employees because of P11D reporting (see above under private health and in Chapter 5). There are implications for Universal Credit and student loan repayments.

8.49 Overall, we think there is in many ways a need for clear policy statements on this whole area.

[4] It was interesting to note that at one London meeting of significant businesses, attenders were surprised to learn that most relief under the late night taxis rule did not go to hospitality/media/healthcare sectors but went instead to 'City-type' businesses.

Staff canteens

8.50 We received few comments about staff canteen arrangements, possibly because the rules are well known, possibly because they are less frequently given in today's working environment. One small issue raised concerns employers who have a director's dining room (taxable) and the directors eat in the (non-taxable) staff canteen occasionally. The employers apparently don't know whether the meal eaten by the director in the canteen is taxable.

8.51 Perhaps because of the changing provision of 'canteens', some questioned why there is a need for the link to exemption for working lunch provision.

Third party benefits

8.52 The rules can cause problems, simply because employers are not always aware of third party benefits. One meeting suggested there are particular problems with employer NICs. There can be a complex interaction with the disguised remuneration legislation.

Training

8.53 Work related training is non-taxable if contracted by the employer as a benefit or if incurred by the employee and reimbursed, but not deductible if not reimbursed. There have been a number of cases before the Tribunals and higher courts on this area in recent years.[5]

8.54 Although it was not often cited to us as problem (as we talked mainly to employers) it seems to us that there is a need for a policy review in this area. Should employees be encouraged to keep skills up to date (or broaden them) through the tax system? We can readily see that there would be concerns over abuse but the regular exhortation to schools and employers to train should perhaps be mirrored better in the tax system.

8.55 A point made by a few employers is that the training exemption is too narrow as many employers offer wider training in life skills etc., i.e. beyond strict training for the job being done. Training is another example of an area where salary sacrifice arrangements are being used by a few employers.

Trivial benefits

8.56 The subject of trivial benefits has already been touched on in Chapter 1 as an illustration of where the rules are complex and inconsistent. We give more details here.

8.57 Trivial benefits were raised in a lot of our meetings. The problem seems to be inconsistency in what is accepted as trivial; this led to regular calls for HMRC to publish a list of what is acceptable.[6]

8.58 When this subject was raised, the example of Ireland (where one benefit of Euro250 a year is allowed as tax-free) was often mentioned. This concept attracted some support; others were less keen on its 'cliff edge' approach. One point strongly made was that if such an exemption was introduced, no employer would suddenly start to give an extra benefit to take advantage of the exemption: business considerations would override (and a rule could surely be introduced to prevent a salary sacrifice route being used/promoted).

[5] See in particular HMRC v Banerjee [2010] EWCA Civ 843 (where Dr Banerjee was successful).

[6] In more than one of our meetings there was an animated debate between attenders who were comparing notes on what each had had accepted as 'trivial' by HMRC, with some anguish from employers who felt they seemed to have been badly done to! Flowers were a regular source of differing treatments: in one meeting amounts allowed as trivial for 'non work' flowers ranged from £50 to £nil.

8.59 Quite a few employers suggested that the rule should be framed in terms of 'non work related' items: so a bunch of flowers to mark the birth of a child would be trivial and not taxable, but a bottle of whisky for a job well done would remain a benefit even if trivial. There was also a call for vouchers to be allowed under a recast trivial benefit rule: the point was made more than once that a bottle of wine or a turkey, often accepted as trivial, would not be acceptable to some employees for cultural or religious reasons.

Transfer/use of assets

8.60 The rules around private use of company assets did not often come up in our meetings but they did get raised on occasions, probably reflecting the limited volume of such provision. The difficulties cited included:

- applying the 20 per cent rule when there was mixed use of an asset (e.g. an aeroplane);
- the requirement that the 20 per cent charge was based on market value when first provided – which was unfair when an asset was used successively by different employees;
- income tax/NIC differences; and
- transfer values at the end of the use period: this is mainly in terms of computers and mobile phones transferred to an employee where technological advances mean the asset can be worth little at the end of two years but there is still tax on a significant value.

8.61 One company reported arguments around iPads which were being given to mobile staff instead of mobile phones and laptops. They were work tools but did not seem to be readily accepted by HMRC as qualifying for exemption from a benefits charge as a mobile phone or PC. It was suggested this was an illustration of the tax system not keeping up with technology.

8.62 A number of employers have moved towards asking employees to use their own PCs/iPads (a Bring Your Own Devices (BYOD) to work strategy). This is in part driven by risk management issues, including problems around controlling unauthorised use of iPads (which we were told was not possible in the same way as PCs could be controlled). Giving staff an allowance to buy their own machine naturally leads to a benefit but a deduction of any sort would be time consuming on all sides to argue for. Some people suggested 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.

Vans

8.63 We did not hear any particular problems from employers about van benefits, and the rules on private use seem to work well. Employees generally lay down strict rules about private use and police them appropriately. A couple did call for a separate van mileage rate.

Vouchers

8.64 The rules for NICs and PAYE differ and this can cause real problems. There is huge unnecessary legislative complexity according to some people we spoke to (e.g. around cash v non-cash vouchers), but HMRC specialists do not see any difficult problems reaching them. This could be that the system is after all simple to apply, or it could be because HMRC staff aren't noticing when the rules are being misapplied and thus not referring problems onwards.

8.65 As noted in Chapter 4 on Travel and Subsistence, a voucher issue in London is Oyster cards. Employers who give these out for business travel around London have a great deal of hassle monitoring private use for minimal amounts of money.

8.66 One interesting point was made by an employer who runs a staff shop where staff can buy their employer's products at cost. This is of course seen as a useful benefit. However, it is increasingly impractical to run (as staff are scattered) and the employer would like to be able to give vouchers that gave an equivalent discount at a normal retailer. That would of course be a taxable benefit.[7]

Expenses

Entertainment

8.67 The 'Christmas party' exemption is still widely used and cherished. However, it was interesting to note that 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. This is partly a response to economic difficulties, partly a realistic response to allow teams to decide their own events. The result is that some events will not qualify as not being 'available to all staff'.

8.68 The 'cliff edge' nature of the exemption causes problems. There is a lot of time spent on allocation of cost if a couple of events just go over the £150 limit. We were also told (by HMRC) that they regularly see smaller employers treating the £150 as an allowance and trying to PSA the balance.

8.69 There is a problem with one-offs, such as centenaries, or biannual events, as these are not going to be 'annual'. Although HMRC may accept them, it does take time and effort to obtain the exemption.

8.70 Charities have difficulty distinguishing between entertaining and marketing costs.

8.71 There can be issues over distinguishing staff entertaining from client entertaining: how many of each (or what ratios) are needed? Clearer rules would help.

8.72 Overall, this would ideally be an area for a proper review.

Set expenses

8.73 One or two employers told us that the fixed rate expenses (e.g. for nurses' uniforms) cause problems. This is partly because they are too low but primarily because few seem to know about them or how to claim them. The result is the growing problem with 'high volume' agents promising to claim tax back for people by claiming expenses on their behalf for things like use of home or clothing. We have heard reports that around 80 per cent of these claims fail, but where they succeed then the agent claims a large proportion of the tax repayment. HMRC have of course identified such agents as a significant source of risk and are considering action.

8.74 One way to solve the issue would be for HMRC to issue simpler guidance so people could understand better what expenses they can claim. Another would be to scrap these fixed allowances. That would no doubt be widely attacked but a one-off lump sum to compensate might be a simpler route to follow.

[7] We note that some employers give staff discount cards rather than having a staff shop and we understand these do not cause problems.

Pecuniary liabilities

8.75 The rules are difficult to understand and illogical.

Personal incidental expenses (PIEs)

8.76 The limits are out of date, especially for overseas laundry.

Removal expenses

8.77 The £8,000 limit on tax-free removal expenses is out of date, having last been updated in 1993. Some major employers told us it probably costs more to track the expenses than the benefit is worth. Some made the point that it covers the cost of moving someone from rented property to rented property (for example, a tenant of a pub). But most who move staff from owned property say it is completely unrealistic and they automatically assume it does not apply.

8.78 Inevitably, most people said that the limit should be raised significantly or (preferably) abolished completely. It was accepted that there would need to be some control to prevent abuse but the point was regularly made that employees very rarely see being moved as a benefit: it is something they are required to do by their employer. Indeed, we were regularly told that far more employees refuse a move and prefer to 'weekly commute' (which causes travel and subsistence issues, considered elsewhere).

8.79 Some people suggested there should be a higher limit for people relocating to the UK from overseas. Others thought there should be a tax free allowance that people are free to spend as they wish. An interesting example was given by a health service trust who told us that they frequently have to ask doctors to move but are faced with the doctor saying they cannot afford to move; they are given a 'moving allowance' equivalent to the £8,000 which is then taxable.

8.80 The 5 April requirement in s274 ITEPA was seen as unfair as it gives widely differing periods in which the removal expenses can be incurred for the purpose of the relief depending on when the move takes place in the tax year. It would be fairer to frame the rule in terms of 'X months after commencement of the new duties'.[8]

8.81 One person asked why relocation expenses needed to be entered in three different places on the form P11D. Once is enough.

8.82 This does seem an area for a proper policy review. One multinational commented that they have at any one time 100-150 UK nationals working elsewhere in the world; they are gaining experience and expect to come back and work in the UK in due course, to the benefit of the UK economy. Surely the tax system should encourage this, not penalise? We also had an excellent example provided by a University. They are under pressure from the Department for Business Innovation & Skills (BIS) to bring in overseas academics. Yet if they manage to hire any (assuming they can negotiate Home Office rules), the agreed package will naturally include relocation costs. Such costs will inevitably be well above the £8,000 limit, leading to a benefit-in-kind. But that cannot be paid under PSA (as HMRC tend to refuse PSAs in respect of non-doms), meaning the new academic is greeted with...a significant tax bill. It does seem a fine example of non-joined up government.

Subscriptions to professional organisations

8.83 This area is generally managed without significant difficulty, though the HMRC listing is cumbersome and can be slow to update.

[8] This suggestion was made by one of the HMRC specialist teams we talked to.

8.84 Some people thought that subscriptions to organisations with a clear business purpose should be allowed automatically, even if they were not on HMRC's approved list. There is an issue over business networks where employees are encouraged to join for business reasons (one example was the 'London Women's Business Network').

Uniform and clothing costs

8.85 These are occasionally a problem, usually when reception staff don't have a 'standard' uniform (especially in the hospitality industry) and have clothing that can be seen as usable privately. Some requested a clear rule from HMRC on 'logos'.

8.86 Charity T shirts were cited as a problem area – for collectors and volunteers. They would be a good candidate for automatic trivial benefit exemption.

8.87 The rules should be clarified so people can claim expenses themselves rather than relying on dedicated claims agents who took a relatively high percentage of any tax reclaimed.

A Consultative Committee members

Andy Read	Balfour Beatty
Andy Richens	Bishop Fleming
Anne Palmer	HM Revenue & Customs
Brigid Simmonds	Beer and Pub Association
Colin Ben-Nathan	KPMG/Chartered Institute of Taxation
David Heaton	Baker Tilly/Institute of Chartered Accountants in England and Wales
Duncan Weldon	TUC
Emanuel Meyer	Meyer Consultancy
Jackie McGeehan	HM Revenue & Customs
Jackie Petherbridge	The Payroll Practice/Federation of Small Businesses
John Hampton	BT/CBI
John Mundy	HM Treasury
Peter Gravestock	Sole practitioner
Simon Parsons	Ceridian UK Ltd/British Computer Society/IReeN
Tony Page	Telefonica
Trevor Blackmur	Association of Taxation Technicians/TRB Tax and Payroll

B List of meetings held

B.1 At many of the meetings listed below there were several different people present. We estimate that we spoke to around 500 people including HMRC frontline staff, payroll managers, tax specialists, and advisers. We tried to visit people across the UK, not just in London and the South East. The total number of meetings and teleconference calls was 55.

B.2 We visited Birmingham, Bristol, Blackpool, Bournemouth, Crawley, Glasgow, Leeds, London, Manchester, Newcastle, Salisbury, Solihull and Warwick.

List of OTS meetings

Aspire Business Partnership

Association of Labour Providers

Association of Accounting Technicians

Aviva

Bond Williams Recruitment, small business workshop, Bournemouth

British Hospitality Association

British Universities Finance Directors Group

British Vehicle Rental and Leasing Association

BT

Business Application Software Developers Association

Cameron McKenna

Capita

CBI

Charity Tax Group

Chartered Institute of Payroll Professionals

Chartered Institute of Taxation, Employment Taxes Sub-Committee

Chartered Institute of Taxation, Northern Ireland branch

Country Land and Business Association

Cyclescheme and Cycle to Work Alliance

Deloitte clients and others in London and Crawley (large employers)

Ex-pats tax managers group

HMRC Appeals team, York

HMRC benefits and expenses forum

HMRC Central Compliance operations

HMRC High Net Worth Unit

HMRC Large Employers' Compliance team, Longbenton

HMRC Local Compliance

HMRC P11D process team

HMRC P87 compliance and processing teams

HMRC Personal Tax Change BPR Programme

HMRC Personal Tax Technical team, Solihull

HMRC Business Tax Technical team, Belfast

HMRC NICs Technical team, Longbenton

Independent Schools' Bursars Association

Institute of Chartered Accountants in England and Wales

Institute of Chartered Accountants in Scotland

ISIS Support Services ltd

KPMG clients and others in London, Birmingham, Glasgow, Leeds and Manchester

Lawspeed

London First (large employers)

Low Incomes Tax Reform Group

The Learn Centre

National Farmers Union

Network Rail

North and Western Lancashire Chamber of Commerce

Payroll Practice

Professional Passport

PricewaterhouseCoopers clients, Belfast

Staffline Group

B.3 In addition to meetings, we also received valuable feedback from people emailing us, and are grateful to all those that sent their comments.

C Statistics and data

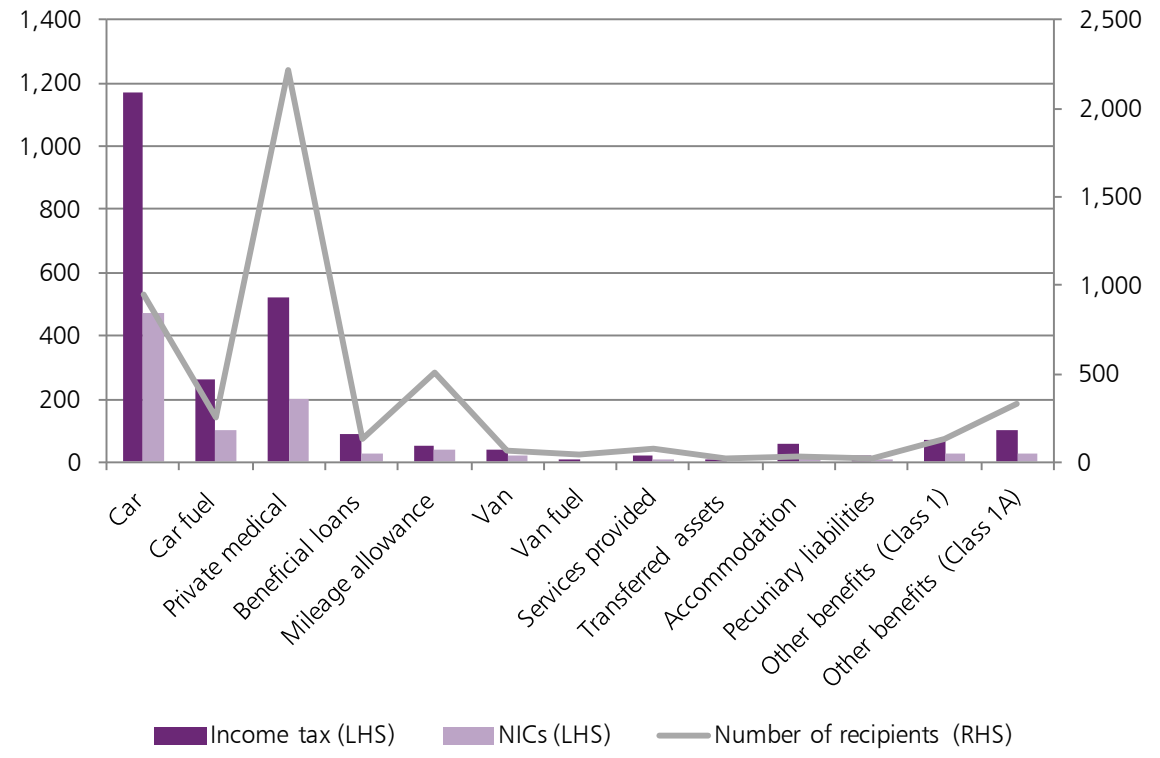
C.1 HMRC publishes statistics on employee benefits and expenses annually on its website: http://www.hmrc.gov.uk/statistics/tax-benefits.htm.

C.2 HMRC has given us some more detailed analysis of the published statistics, and some other data and information that has not been published before. We are very grateful for this help, particularly from their Knowledge Analysis and Intelligence unit.

Benefits

C.3 Chart C.1 shows the numbers of recipients, and tax and NICs for each benefit in 2010-11.

Chart C.1: Benefits in kind – total income tax and NICs receipts (£m) and number of recipients (000s)



Source: http://www.hmrc.gov.uk/statistics/tax-benefits.htm

C.4 As the chart above shows, 81 per cent of income tax and NICs revenues come from just three categories: cars, car fuel and private medical benefits.[1] Looking at the number of taxpayers shows that despite car benefits being the highest in terms of revenue this is spread over fewer taxpayers than private medical insurance.

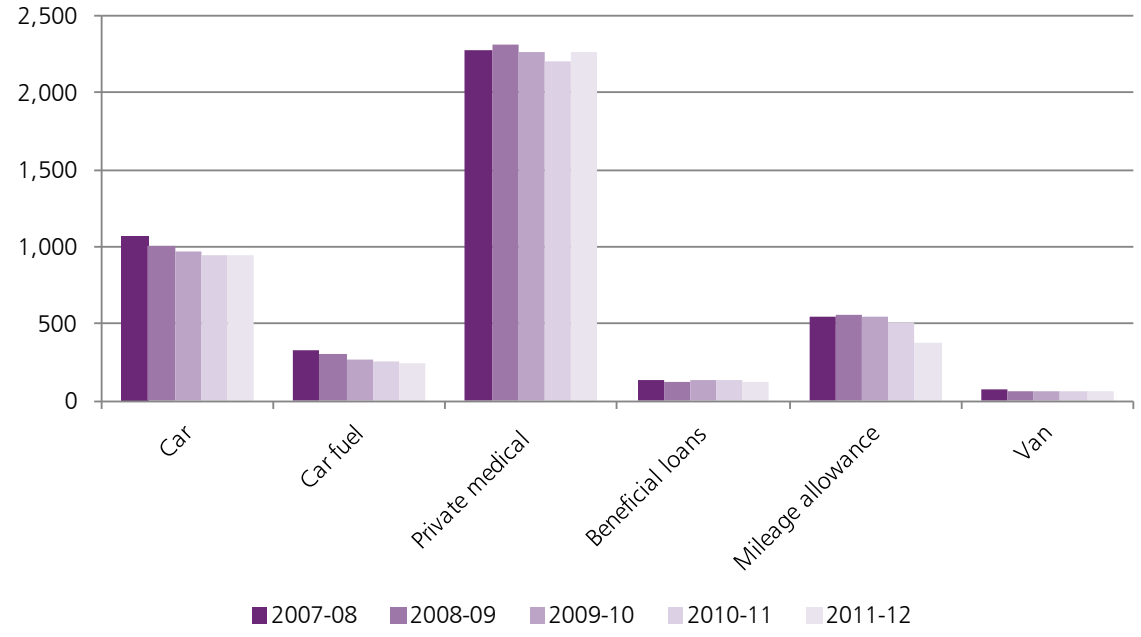
[1] Private medical benefits include dental benefits.

C.5 HMRC's statistics show that the average tax and NIC revenue per taxpayer was £1,700 for car benefits, but just £330 for private medical insurance. The highest average tax and NIC revenue per taxpayer was for employer provided accommodation at £2,900 in 2010-11.

C.6 Historical figures are difficult to come by, with HMRC only publishing tables from 2004-05 online. However, we have been able to find tables from 1983-84 and 1989-90[2] which show a striking increase over that period in the number of people receiving taxable benefits from 1.35 million to 2.87 million. The total value of benefits rose from £0.9 billion to £5.2 billion. The bulk of this was due to car benefits, which increased in value from £390 million in 1983-84 to £3 billion in 1989-90. HMRC tells us that part of the increase was due to a greater variety of benefits being reported later in the year. Also, the 1983-84 figures did not include benefits paid to married women.

C.7 Chart C.2 shows the change in numbers of selected benefit recipients over the last five years. The number of employees receiving car and car fuel benefits has been falling steadily since 2007-08. This is part of a longer term trend going back until at least the early 2000s. Other benefits have remained fairly flat over the period covered. The overall trend has been a fall of 300,000 in taxpayers receiving at least one taxable benefit from 4.0 million in 2004-05 to 3.7 million in 2010-11.

Chart C.2: Trends in numbers of recipients (000s) of selected benefits



Source: http://www.hmrc.gov.uk/statistics/tax-benefits.htm

C.8 Chart C.3 shows that changes in total tax liabilities generally mirror those seen in numbers of taxpayers. Only private medical insurance (increasing over the period) and mileage allowance (flat) of the major categories show significantly different trends. The total tax and NIC liability has fallen by just under £150 million from £3.50 billion in 2004-05 to £3.36 billion in 2010-11.

C.9 Chart C.4 shows how benefits in kind (BIKs) were distributed by income in 2010-11.

[2] http://www.ifs.org.uk/comms/comm36.pdf.

Chart C.3: Trends in tax liability (income tax and NICs) of selected benefits

Source: http://www.hmrc.gov.uk/statistics/tax-benefits.htm

Chart C.4: Total taxable value of BIKs (£m) and number of recipients (000s) by income

Source: http://www.hmrc.gov.uk/statistics/tax-benefits.htm

C.10 The vast majority of tax revenue from benefits comes from individuals earning £30,000 or more. The distribution of recipients does not correspond to the distribution of taxable value as employees with lower incomes receive smaller benefits than those earning more. HMRC figures provided to the OTS show that those earning over £75,000 received 13 per cent of all benefits by number, but 29 per cent of all benefits by total value. Those earning less than £30,000 received 36 per cent of all benefits by number but only 14 per cent by total value.

C.11 HMRC has provided the OTS with the spread of benefits by value. There were 4,280,000 individual benefits reported in 2010-11. Of these, around 500,000 were for benefits with a value under £100, and 1,140,000 with a value between £100 and £500. Table C.1 shows the number of recipients of selected benefits in different value bands.

Table C.1: Number of recipients of benefits in 2010-11, by value

	Car benefits	Car fuel	Private health	Beneficial loans	Accommod-ation	Mileage allowance
£0 – £100	10,000	5,000	230,000	10,000	5,000	220,000
£100 – £500	40,000	10,000	860,000	40,000	5,000	140,000
£500 – £1,000	50,000	10,000	650,000	20,000	5,000	100,000
£1,000 – £5,000	620,000	200,000	470,000	40,000	10,000	50,000
£5,000 – £10,000	190,000	20,000	10,000	5,000	-	-
£10,000+	30,000	-	-	5,000	5,000	-
Source: HMRC figures						

C.12 HMRC estimates that about 5 per cent, by value, of benefits are payrolled. Employers must still submit P11Ds even if benefits are payrolled, but these are not captured on HMRC's IT systems.

PAYE Settlement Agreements and dispensations

C.13 PAYE Settlement Agreements are agreements between HMRC and employers under which the employer agrees to pay the tax on certain benefits rather than report them on forms P11D. Table C.2 is an analysis of PSAs. The most common categories for PSAs were small gifts (about 20 per cent of the total) and lunches (about 17 per cent). All other categories accounted for much smaller percentages of the total.

Table C.2: HMRC data on numbers of PAYE settlement agreements (rounded to nearest 100)

Subject	2007-08	2008-09	2009-10	2010-11	2011-12
Client entertainment with benefit	200	200	200	100	200
Spouse's travel	300	400	400	400	400
Spouse's accommodation and subsistence	100	200	200	200	200
Working lunches	4,900	5,700	6,500	7,100	6,700
Team building events	1,800	2,100	2,400	2,800	3,300
Annual functions	3,000	2,900	2,500	2,400	1,900
Conferences with benefit element	100	100	100	100	100
Welfare services	600	700	700	700	700
Long service awards	1,600	1,800	1,900	2,000	1,900
Retirement packages	200	200	200	200	300
Small gifts	6,900	7,000	7,500	8,200	7,800
Self improvement services	<50	<50	<50	<50	<50
Suggestion scheme awards	<50	100	100	100	100
Conferences	<50	<50	<50	<50	<50
Incentives arranged by employer	1,500	1,600	1,800	1,900	2,000
Formal incentive award schemes	200	200	300	300	500
Other prizes and incentives	1,200	1,400	1,500	1,600	1,600
Mobile telephones	200	300	300	300	200

Medical expenses	1,100	1,400	1,500	1,600	1,600
Shared cars	200	100	200	200	100
Other shared assets	<50	<50	<50	<50	<50
Chauffeurs	100	100	100	100	100
Vans	100	100	100	100	100
Assets available for private use	400	400	500	500	500
Assets below market value	200	200	200	200	200
Goods or services below market value	1,000	1,500	1,600	1,600	1,400
Relocation expenses or benefit	900	1,200	1,300	1,400	1,200
Home to office travel expenses	1,300	1,600	1,700	1,800	1,500
Excess mileage and travel expenses	500	700	800	900	800
Excess subsistence payments	700	1,000	1,100	1,200	1,000
Club membership subscriptions	800	1,000	1,000	1,100	900
Subscriptions to professional bodies	200	200	300	300	300
Other pecuniary liabilities	2,500	2,600	2,500	2,600	2,200
Total number of agreements	**32,900**	**37,100**	**39,400**	**41,900**	**39,500**
Total number of PAYE schemes with a PSA	**17,200**	**17,100**	**18,000**	**18,900**	**19,100**
Source: HMRC data					

C.14 HMRC has also given us details of dispensations it has granted. These are agreements between HMRC and employers that certain expenses do not need to be returned on forms P11D because they could be matched with allowable expense claims. An analysis of these dispensations is at Table C.3.

Table C.3: PAYE schemes, P11Ds, and dispensations

Administrative process[3]	**Number**
Total number with at least one PAYE scheme for the main benefits – 2011-12[4] [5]	305,000
Total number of P11Ds – 2010-11[6]	4,474,000
Total number of PAYE settlement agreements – 2011-12	39,500
Total number of different PAYE schemes with at least one agreement – 2011-12	19,100
Total number of dispensations agreed in 2012	134,000
Total number of dispensations agreed since 2008	562,000
Source: HMRC data	

[3] All figures are estimates and subject to a number of caveats.

[4] Benefits include the following: cars, car fuel, private medical and dental, beneficial loans, mileage allowance, van, van fuel, services provided, transferred assets, provided accommodation, payments on behalf of employee, other benefits (Class 1), vouchers/credit cards, entertainment, subscriptions, travel and subsistence, home telephone, general expenses allowance for business travel, general expenses, qualifying relocation expenses.

[5] A single employer can have more than one PAYE scheme.

[6] A small number of employers are missing from the total and most of this is due to payrolled expenses which are not fed into the system in the same way as non-payrolled expenses.

C.15 The main categories for dispensations were receipted travel and subsistence (16 per cent of the total), business entertaining (18 per cent), home phone calls (13 per cent) and company credit cards (15 per cent). Although dispensations should be reviewed every five years there are still a number which appear in force on HMRC's systems from before 2008.

Expenses

C.16 HMRC used to publish data on expenses reported on forms P11D, but stopped doing this in 2010 after a sampling exercise showed that the great majority of these expenses were non-taxable.

C.17 The latest data published was for 2007-08. This is reproduced in Table C.4 below. The table also shows figures in brackets for amounts reported in 2010-11, supplied to the OTS by HMRC. The figures are very similar, apart from professional subscriptions which may reflect increasing numbers of dispensations covering this category.

Table C.4:

Expense type	Amount reported in 2007-08 (2010-11)	Proportion not taxable (in 2007-08)
General expenses	£180 million (£200 million)	57% - 79%
Travelling and subsistence	£550 million (£580 million)	74% - 86%
Entertainment	£120 million (£110 million)	66% - 91%
Home telephone	£30 million (£20 million)	-
Subscriptions	£50 million (£20 million)	16% - 70%
Vouchers/credit cards	£140 million (£140 million)	63% - 78%
Other expenses (not relocation)	£20 million (£10 million)	-
Source: http://www.hmrc.gov.uk/statistics/tax-benefits.htm		

Administrative burdens and costs

C.18 KPMG carried out an exercise in 2006 for HMRC to measure administrative burdens. It published a report on employer taxes that is available online at: http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/better-regulation/part11.pdf.

C.19 The key findings were that:

- employer tax burdens made up 15 per cent of total business burdens in 2006;
- the second biggest employer burden was the P11D process, estimated to cost £131 million for all businesses in 2006. The burden of online filing for the employer was generally considered by business to be similar to paper filing; and
- KPMG estimated that the burden of completing P11Ds was reduced by 30 per cent if a dispensation has been granted by HMRC.

HMRC website hits

C.20 HMRC has given us statistics on how many unique visitors to relevant pages of its website in 2012-13. These are set out in Table C.5 below.

Table C.5:

URL	Unique visitors in 2012-13
http://www.hmrc.gov.uk/incometax/how-to-get.htm	538,827
http://www.hmrc.gov.uk/incometax/codes-expense-pay.htm	77,171
http://www.hmrc.gov.uk/incometax/codes-company-benefits.htm	110,532
http://www.hmrc.gov.uk/working/bens-shares-tips/benefits.htm	70,217
http://www.hmrc.gov.uk/calcs/cars.htm	822,583
	Downloads in 2012-13
http://www.hmrc.gov.uk/forms/p87.pdf	192,698
http://www.hmrc.gov.uk/agents/toolkits/exp-ben-frm-emp.pdf	5,488
Source: HMRC data	

C.21 It is not possible to get data on the number of visitors to the car and fuel benefit calculator. However during the period from 06-04-13 to 16-06-13 there were 194,751 visitors to the landing page of which 111,000 left the site. The customers who went on to use the calculator will be included in the 111,000 who left the site so we can infer from that that the majority of visitors to the landing page went on to use the calculator.

D History of legislation

D.1 This annex sets out a summary of the main legislative changes for employee benefits and expenses. It shows very clearly how the regime has developed in a piecemeal fashion over the years, with no fundamental policy review since the mid 1970's.

1842	Schedule E charge on salaries, fees, wages and perquisites.
1853	Gladstone introduces the rule for deduction of expenses.
1892	Tennant v. Smith: only things which can be turned to money are income.
1944	Introduction of PAYE.
1948	Start of the benefits code. Introduced the concept of differing rules applying to "higher paid" employees and directors with the threshold at £2000. Accommodation rules introduced. Dispensations introduced. The rules for expenses were changed so that an employee became taxable on the amounts reimbursed by his employer but could claim a deduction for expenses meeting the narrow deduction test. Introduction of the current universal National Insurance system following the Beveridge Report.
1960	Charge to tax on termination payments introduced, excluding the first £5,000.
1966	Statutory redundancy payments exempted from income tax.
1972	Exemption for compensation payments not to apply to compensation for loss of office.
1975	"Higher paid" employees threshold increased to £5,000. Anti-avoidance rules introduced dealing with vouchers.

1976	Expenses of private health insurance become taxable. Non-cash vouchers tax base changed. Non-trading employers brought within the benefits code rules. Third party provision made taxable. Private use of company cars made taxable. Beneficial loans taxable subject to a de minimis of £50 of notional interest. Tangible assets provided to employees other than cars to be valued at 10 per cent of the market value at first use. A catch-all provision on benefits of "whatsoever nature" introduced.
1977	Travel to and from overseas and overseas board and lodging for employees taking up overseas employment or on the termination was treated as deductible expenses. Provision also made for spouse and family travel where the employee was overseas for more than 60 days. Accommodation rules amended to. Decision made that there should be an objective test for need; hence use of "customary" test. Directors holding less than 5 per cent of the company were no longer to be treated as "directors" for the higher paid and directors threshold as they would not be able to influence their employer's policies regarding pay. Expenses of accommodation paid to an employee to be taxable up to 10 per cent of net emoluments. 10 per cent considered to be broadly in line with what an employee would have to pay at home anyway. "Higher paid" threshold increased to £7,500. A major factor was the Inland Revenue saving which would result. However, in the long term it was stated to be government's intention to make the benefit code apply to everyone as least as far as cars and loans were concerned.
1978	"Higher paid" threshold increased to £8,500. It was considered broadly to equate to the level at which a married man started paying tax at the higher rates albeit that because of the inclusion of the benefits in the amount a person could earn much less than this in salary. Indexation of the threshold was considered inappropriate. Termination payments exemption increased to £10,000 to cover the great majority of normal redundancy payments. A review of the rules was announced because of perceived abuse.
1979	Inland Revenue consultation on termination payments.

1980	Inland Revenue press statement canvassed abolition of "higher paid" employees distinction. The "higher paid" threshold was recognised as being difficult to defend. However, there was considerable concern about the administrative burden on HMRC if it was abolished. To ease that burden consideration was given to applying PAYE to car benefits. Increase of annual value of tangible assets (other than cars) made available to employees to 20 per cent. Change in base of tax on acquisition of tangible assets: now to be the higher of the amount by which the original market value less the taxed benefit exceeds the price paid by the employee; and the excess of market value at acquisition over the price paid by the employee, to tackle schemes giving employees rapidly depreciating assets. De minimis for the taxable notional interest on beneficial loans increased to £200 (as interest rates were at 15 per cent which in itself caused loans to fall into tax). Consultation on the application of PAYE to the cash equivalent of benefits, and the taxation of petrol. Employees were obtaining tax free petrol where the employer contracted directly with the supplier.
1981	Sick pay financed by employers through insurance to be taxable. Termination payments exemption increased to £25,000. This would cover most payments under the industrial redundancy scheme. The level was expected to last two-three years. Standard capital superannuation benefit which applied to ex gratia payments was abolished recognising that differing treatment for ex gratia and compensation based payments was problematic. Proposal that benefit of cars being used for private purposes by higher paid employees should be subject to PAYE on scale basis. Proposal that petrol or other fuel not reimbursed by higher paid employees should be subject to PAYE on scale basis. The £8,500 higher paid threshold was left "for now", recognising that the car and fuel changes would exacerbate the problem. Vouchers to obtain season or other travel tickets to be taxable. Tax on the interest and fees payable on credit cards used for private purposes. Relief for lower paid employees for cost of medical insurance.

1982	Termination payments tax on the amount above the £25,000 exempt amount changed: ½ the tax rate applied to the next £25,000; ¾ the tax rate applied to the next £25,000 and remainder fully taxed. Indexation or a multiple of earnings rejected. First signs of decision to allow the higher paid threshold to diminish in value over time. Anti-avoidance provisions introduced to deal with voucher schemes aimed at the "lower paid". Charge on credit cards' annual fees and interest removed. Huge resistance from employers to PAYE on car benefits and fuel led to withdrawal of that proposal. The benefit to be reported separately.
1984	Removal of preferential treatment of golden handshakes paid to non-UK domiciled employees of employers not resident in the UK. Rules taxing scholarships given to children of staff at schools tightened. Consultations on overseas travel expenses (1984 and 1985).
1985	The ceiling for employer NICs was removed.
1986	New more favourable rules for overseas travel expenses. Travel expenses paid for unlimited number of outward and return journeys when working abroad were tax-free where the expenses were met by the employer. ESC A23 enacted to provide statutory relief for the travel expenses of non-UK domiciliaries travelling between the UK and home country. A Green Paper on personal tax considered the alignment of income tax and NICs.
1987	Relief introduced for costs of retraining an employee leaving employment.
1988	Car parking at or near work was made tax exempt because of the administrative problems in identifying and quantifying. Exclusion from entertainment charge for entertainment provided by a third party and not in recompense for past or future service. Consideration for restrictive covenants becomes fully taxable, but as this is not an amount of earnings NICs it was recognised that the principles involved need to be considered further before extending NICs to the payments. Termination payments exemption increased to £30,000 and top slicing relief abolished. This was a simplification. It was expected that the vast majority of redundancy payments would be covered by this amount.
1989	"Higher paid" was removed as a term for the £8,500 threshold as it was no longer appropriate. An Inland Revenue press release stated that the Government considered that all employees should become taxable on all earnings whether in cash or in kind. The threshold was recognised as an anomaly and was to wither.
1990	Employer provided workplace nursery and play schemes made exempt from tax.

1991	A standard £200 valuation of mobile phones was introduced unless the employee reimbursed all private calls. Class 1A NICs introduced but applying only to cars and fuel.
1993	New rules introduced for calculating the cash equivalent of vans where private use of them is made. An exemption introduced for heavier commercial vehicles where the use is not wholly or mainly private. An exemption introduced for sporting or recreational facilities provided by the employer for use by the employees generally. The detailed removal expenses rules and the limit of £8,000 were introduced. An exemption introduced for counselling services provided to an employee in connection with the termination of the employee's employment.
1994	Beneficial loan limit set at £5,000 in aggregate per employee. Voucher rules changed to tax the employee on the cost incurred by the employer or third party. Tradable assets rules introduced for PAYE to counteract schemes paying employees in assets which are then sold.
1995	An exemption from tax for personal incidental expenses introduced at the rate of a maximum of £5 per night in the UK and £10 per night overseas.
1996	PAYE Settlement Agreements were introduced, replacing Annual Voluntary Settlements.
1997	New travel expenses rules introduced for the year 1998-99 onwards but...
1998	The new travel expense rules were amended. These are the rules currently in use incorporating such concepts as "ordinary commuting" and "temporary workplace". Amendments to the PILON rules. Anti-avoidance amendments were made to the tradable assets rules to catch "readily convertible" assets.

1999	Loans of mobile phones to employees were made tax exempt. Loans of computers to employees were tax free up to the 20 per cent asset value of the computer being less than £500 or if the computer was rented, up to £500 of annual rental paid by the employer. An exemption was introduced for: • works bus services; • subsidies paid by employers for public transport services used by employees; • employer provided parking facilities for cycles and motor cycles at or near work; and • the loan of cycles or cycle safety equipment. Employees could be paid a tax free amount of 12 per mile for each business mile cycled. Class 1B NICs introduced on PSAs. Class 1A NICs extended to benefits in kind generally.
2000	The use of assets and services in performing duties of employment was made exempt from tax so long as private use is not significant. A regulation making power to exempt from tax minor benefits was taken. Welfare counselling was made exempt from tax under this power.
2001	A new exemption for mileage allowance payments was introduced. The works bus exemption was extended to minibuses. The vouchers rules were amended so that if the voucher is used to obtain a minor benefit which was exempt then the voucher would also be exempt from tax. Consultation on simplifying NICs for employers.
2002	Specified benefits provided in connection with a termination of employment were excluded from charge. Major change in the way car benefit is calculated – now based on CO2 emissions rather than engine size.
2003	Reasonable additional household expenses incurred by an employee in carrying out their work under home working arrangements were made tax free. Up to £2 per week could be paid without supporting evidence. Income Tax Earnings and Pensions Act was passed bringing together legislation, case law and Extra Statutory Concessions. The ceiling on employee NICs was removed.

2004	The employee benefits exemption for loaned computers was extended to over salary sacrifice arrangements. A provision was introduced exempting emergency vehicles provided to employees of the emergency services where their private use was limited. A new limited exemption was introduced for employer contracted childcare and employer provided childcare vouchers. New rules for the taxation of vans were introduced. The Paymaster General announced that action to stop remuneration being paid without PAYE and NICs would be taken whenever it was discovered and this action would be retrospective.
2006	The mobile phone exemption was limited to one mobile phone per employee. A voucher or credit token to obtain a phone would no longer be subject to tax and there was a change in definition of mobile phones to exclude "Blackberrys" and equivalent phones. The exemption from tax for loans lent to employees to be used at home was abolished and employees now to be taxed on the higher of 20 per cent of the market value and the annual rental cost. An exemption for eye tests and glasses for VDU use was confirmed to apply whether the test or glasses were obtained by voucher or other means.
2007	Consultation regarding income tax and National Insurance alignment. Consultation "Benefits in kind and expense payments in the payroll – a fresh approach" considering payrolling benefits and abolishing the £8,500 threshold.
2008	Consultation "Tax relief for travel expenses: temporary workers and overarching contracts".
2009	An exemption introduced for one health screening or medical per year per employee.
2010	The exemption for the provision of subsidised or free meals to employees was no longer to apply where this was part of a salary sacrifice arrangement.
2011	Childcare relief was reduced for employees taxable at the higher rate of income tax. Government consultation regarding income tax and National Insurance alignment.
2012	HMRC interpretation changed to treat smartphones as mobile phones for the mobile phone exemption. In the Autumn Statement the Government stated that it would "wait for further progress on planned operational changes to the tax system before formally consulting on the operational integration of income tax and NICs".

E Tax and NIC differences

E.1 A summary of the main misalignments between the income tax and NICs treatment of benefits and expenses follows on the next page.

Type of payment or method of provision	Legislation[1] (is the item taxable and liable for employee or employer NICs?)			Operational treatment[2] (is the item reported on the P11D or included in payroll/PAYE?)			Is the treatment aligned?		Notes
	Income tax	Employee NICs (Class 1 primary)	Employer NICs (Class 1 secondary or Class 1A)	Income tax	Employee NICs (Class 1 primary)	Employer NICs (Class 1 secondary or Class 1A)	Legislation	Operation	
Benefits in kind (excluding those on which employee NICs are already charged) Includes cars, car fuel, vans, van fuel, living accommodation, beneficial loans, private health, relocation benefits, use of assets	Yes	No	Yes – Class 1A	P11D	-	P11D(b)	Partially	Partially	Employer NICs are calculated by reference to the amount of benefit for income tax, but there is overall misalignment because tax on benefits in kind falls on the employee whilst NICs fall on the employer. Operationally, there is some alignment as the employer uses the P11D as the starting point for the P11D(b) Class 1A NICs return.

[1] The purpose of this entry is not to identify the various differences in the legislation (e.g. there is no equivalent to sections 90 to 96A ITEPA (credit tokens in NICs legislation) but to identify whether the absence of any legislation renders a charge in one code but not the other (e.g. in relation to the provision of a company car available for private use there is an income tax charge on the individual but no corresponding NICs liability.

[2] The purpose of this entry is to identify differences in the administrative treatment of the two charges, albeit that for both tax and NICs the separate processes are supported by legislative frameworks. For ease of reference, the table refers solely to form P11D. However, certain types of benefit and non-cash earnings will be reportable on form P9D for those employees not covered by form P11D. Main examples are vouchers and credit cards, living accommodation, pecuniary liability, "money's worth" items such as transfer of asset/ gifts-in-kind, and certain expenses payments. The distinction for tax between benefits that are only taxable on directors and on employees earning at a rate of at least the £8,500 threshold is not currently a source of tax/ NICs misalignment and therefore this distinction is not explicitly covered in the table.

Type of payment or method of provision	Legislation (is the item taxable and liable for employee or employer NICs?)			Operational treatment (is the item reported on the P11D or included within the payroll/ PAYE?)			Is the treatment aligned?		Notes
	Income tax	Employee NICs	Employer NICs	Income tax	Employee NICs	Employer NICs	Legislation	Operation	
Benefits in kind – mixed use assets, not including cars, vans or living accommodation	Yes, but exclude business use element	No	Yes, Class 1A NICs on full taxable value of benefit. No deduction for business use	P11D	-	P11D(b)	No	No	The policy that Class 1A NIC liability applies to the full taxable value before any partial deduction for business use stems from responses to the consultation when Class 1A liability was extended from company cars to other benefits in kind. Although this can be viewed as a rough edge, it also delivers simplification as employers do not need to keep detailed records of private use, they do not have to be concerned about whether their employee is making a claim for business use and they have certainty of liability at a specified date.
Vouchers	Yes	Yes	Yes	P11D	Payroll tax	Payroll tax	Yes	No	The provisions for valuing the cost of the voucher and for exemptions/ disregards are fully aligned. The only real misalignment is that the tax liability is not subjected to PAYE so the employer has an in-year process for NICs and an end-of-year P11D process for tax.

Type of payment or method of provision	Legislation (is the item taxable and liable for employee or employer NICs?)			Operational treatment (is the item reported on the P11D or included within the payroll/ PAYE?)			Is the treatment aligned?		Notes
	Income tax	Employee NICs	Employer NICs	Income tax	Employee NICs	Employer NICs	Legislation	Operation	
Cash reimbursement advance to cover mixed business/private expenses (not round sum allowances)	Yes, but exclude business use element	Yes, but exclude business use element	Yes, but exclude business use element	P11D	Payroll PAYE	Payroll PAYE	Yes	No	Money payments (whether paid as an advance or a reimbursement) that relate to a cost that is not employment-related (e.g. private use of a telephone) are earnings for tax and NICs and are also subject to PAYE. In contrast, reimbursement (or advance) in respect of a business expense will be disclosed on P11D and may be subject to a relief claim for tax. For NICs the item is dealt with in the payroll with employer determining business element and deducting employee and employer NICs on the non business element.
Payments wholly for business expenses	Yes But if wholly for qualifying business/ travel expenses, nil taxable after matching deductions	No	No	P11D – unless employer has dispensation	-	-	No	No	Tax and NICs have different legislative definitions as to what amounts to a business expense: e.g. – "wholly, exclusively and necessarily" for tax v "specific and distinct" for NICs. These rules are supplemented by rules on travel expenses, with these rules being aligned for tax and NICs.

Type of payment or method of provision	Legislation (is the item taxable and liable for employee or employer NICs?)			Operational treatment (is the item reported on the P11D or included within the payroll/ PAYE?)			Is the treatment aligned?		Notes
	Income tax	Employee NICs	Employer NICs	Income tax	Employee NICs	Employer NICs	Legislation	Operation	
Employer supplied credit cards and/or tokens	Yes, but exclude business use element	Class 1, but exclude business use element	Class 1, but exclude business use element	P11D	Payroll PAYE	Payroll PAYE	Yes	No	In certain circumstances tax may be deducted under PAYE – see for example s695 ITEPA 2003.
Employer supplied credit cards and/or tokens Purchase on behalf of employer and ownership of item transferred to employee	Yes Taxed as transferred asset	No Item provided is a benefit in kind	Yes Class 1A	P11D	-	P11D(b)	Partially	Partially	The effect of purchasing the item on the employer's behalf and then transferring ownership to the employee renders the item a transferred asset for both tax and NICs purposes. But the legislation is not aligned because there are no employee NICs on the benefit.
Pecuniary liability – payment of employee's personal bill	Yes	Yes	Yes	P11D	Payroll	Payroll	Yes	No	The business use part of any personal bill is not chargeable to tax or NICs. A claim for relief is needed for tax. The extent of any NIC relief will depend upon the contractual arrangements. Where the contract is with the employee relief is available against any business use. Where the contract is with the employer relief is available if there is a fully matching tax deduction.

Type of payment or method of provision	Legislation (is the item taxable and liable for employee or employer NICs?)			Operational treatment (is the item reported on the P11D or included within the payroll/ PAYE?)			Is the treatment aligned?		Notes
	Income tax	Employee NICs	Employer NICs	Income tax	Employee NICs	Employer NICs	Legislation	Operation	
Round sum allowances (including where a proportion of the amount claimed can be identified as business expenditure)	Yes	Yes Class 1	Yes Class 1	Payroll PAYE	Payroll PAYE	Payroll PAYE	Partially	Partially	There is no operational misalignment where the round sum is just for private expenditure. But if part is business expenditure, the effect of the two charges is to impose tax and NICs on the profit element of a round sum allowance only. The legislative and operational means of obtaining that result are different, albeit that PAYE is the collection mechanism.
Non-reimbursed business expenses (out of pocket expenses)	N/A	N/A	N/A	N/A	N/A	N/A	No	No	The taxpayer can seek tax relief on non reimbursed expenses direct from HMRC. There is no legislative equivalent for either employer or employee NICs and as a result no mechanism for claiming NICs relief.
Special rules for relocation expenses, mileage allowance, travel expenses subscriptions/ professional fees and personal incidental expenses	Yes	Yes Class 1	Yes Class 1	P11D	Payroll PAYE	Payroll PAYE	Largely	No	Largely the legislative rules are aligned. There are slight differences because of the structure of NICs –the NICs scheme is more generous to employers/earners in not operating the two authorised mileage rates but is less generous to earners in not offering full mileage allowance relief.
Lower paid employees (earning less than £8,500 pa)	-	-	-	-	-	-	Partially	Partially	For Class 1 purposes this rule does not exist but it is replicated for Class 1A. For Class 1B purposes it depends upon the item included in the PSA.

F International comparisons

F.1 As part of our review we have started to look at how other tax jurisdictions treat employee benefits and expenses for tax purposes, starting with a small selection of countries. Here is a summary of our findings so far. Interestingly three of the countries we looked at, Canada, Ireland and the USA all payroll taxable benefits. We came across two countries, Australia and New Zealand where it has been decided that the employer should bear the tax liability on benefits in the form of fringe benefit tax.

Australia

Benefits

F.2 Fringe benefit tax (FBT) is payable by employers on benefits provided by the employer, an associate of the employer or a third party under an arrangement with the employer.[1] It is payable on benefits and expenses provided to current, future or former employees. Generally benefits provided to volunteers and contractors don't attract FBT. Most minor benefits valued at less than $300 are not taxable where it would be unreasonable to treat the benefit as a fringe benefit. Examples include, protective clothing, an item of computer software or tools of the trade.

F.3 FBT is self-assessed by the employer. The rules for calculating the taxable value of benefits vary according to the type of benefit. The rate is levied on the 'grossed-up amount', to reflect the gross salary employees would have to earn at the highest marginal tax rate to buy the benefits after paying tax.

F.4 Employers make an annual FBT return and generally pay FBT quarterly. If an employer provides fringe benefits with a total taxable value of more than $2,000 to an employee in an FBT year, they need to report the grossed-up taxable value of the fringe benefits on the employee's payment summary for the corresponding income year. There may be issues around getting double tax relief when FBT is applied to benefits taxed on the employee in other countries. Australian tax treaties generally have a special rule to address this.

F.5 Employers such as public benevolent institutions, public and non-profit hospitals and public ambulance services, religious institutions and other non-profit entities may be eligible for concessional FBT treatment.

Salary sacrifice

F.6 The Australian tax authority has been closely looking at salary sacrifice or salary packaging, as it's called in Australia. In 2012 the government announced reforms applying from 1 April 2014 to remove the concessional fringe benefits treatment for in-house fringe benefits accessed through salary sacrifice arrangements.[2]

[1] Fringe benefits tax – a guide for employers

[2] http://www.ato.gov.au/content/00339112.htm

Expenses

F.7 The taxable value of the expenses fringe benefit is reduced by the amount the employee would have been entitled to claim as an income tax deduction if they had not been reimbursed. The rules on allowable travel expenses are similar to the UK.[3]

Canada

Benefits

F.8 Taxable benefits are payrolled and also subject to Canada Pension Plan and Employment Insurance deductions.[4] Benefits are reported on the employee's T4 slip. The value of a taxable benefit is generally its fair market value (FMV), the price that can be obtained in an open market between two individuals dealing at arm's length. The cost to the employer can only be used if it reflects the FMV.

F.9 Private health services plan premiums paid by the employer are not taxable. If the employee pays this is also tax deductible.

Expenses

F.10 Employees can claim certain employment expenses on their income tax and benefit return, if under the contract of employment the employee had to pay for the expenses in questions. The contract does not have to be in writing but both parties have to agree to the terms and conditions and what is expected. An example is a formal teleworking arrangement where the employee pays for the expenses of their work space. Employers have to complete a Form T2200 which is a declaration of conditions of employment and employees need to keep this declaration in case the CRA chooses to inspect it.

F.11 Travel and board expenses incurred when working at a temporary site can be paid free of tax and social security, but they have to be reported on a return. The rules around temporary work places are not based on duration of the post or the amount of time spent at the temporary location, but they are more stringent than the UK rules in other respects:[5]

- the employee has to maintain their original home and keep it available for their occupancy during the period. They cannot rent it out;
- the employee cannot be expected to return daily from the work site to their principal place of residence; and
- for board and lodging, the period spent away from the employee's base has to be at least 36 hours.

F.12 There are special rules for remote work locations which are reflective of Canada's geography that are not really relevant for the UK.[6]

F.13 Reimbursed relocation costs are not capped provided they fall within the list of allowable expenses. If the employer does not reimburse all qualifying expenses the employee can claim a deduction against their taxable expenses.

[3] http://www.ato.gov.au/individuals/content.aspx?doc=/content/00342097.htm.
[4] http://www.cra-arc.gc.ca/E/pub/tg/t4130/t4130-e.html.
[5] http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/brd/spcl/menu-eng.html.
[6] http://www.cra-arc.gc.ca/tx/bsnss/tpcs/pyrll/bnfts/brd/rmt-eng.html.

India

F.14 In India employers generally compute and withhold income tax and social security from an employee's salary.[7] A wider range of employer expenditure is not taxable on the employer or employee compared to the other countries reviewed. For instance employers can pay a certain amount towards accommodation and commuting tax free. These differences seem to reflect cultural differences.

F.15 A benefit that might be considered unusual for those living outside the UK is leave travel. Depending on the mode of travel a certain amount will be excluded when an employer remunerates employees to meet the travelling expenses incurred by the individual and family members (including dependent parents and brothers and sisters). Two journeys in a block of four calendar years are exempt. Education payments for up two children up to INR50 are exempt from tax.

F.16 Employers can pay a tax exempt, but capped, House Rent Allowance (HRA) to their employees.

F.17 Transport payments of up to INR800 (US$14.22) per month for an employee commuting between their residence and place of work are exempt from taxes.

Ireland

Benefits

F.18 Since 2004 employers have been required to operate PAYE, PRSI and the Health Contributions on the taxable value of benefits in kind and other non-cash benefits.[8] Benefits are taxable on employees with total remuneration of 1,905 Euros in a tax year. Employers use a best estimate approach based on the cost to the employer. If the estimate is too low the Revenue can turn to employee. If there is insufficient salary to cover deductions then the employer covers the shortfall and the employer needs to repay by the end of the tax year (deadline extended three months by concession).

F.19 There is a small benefits exemption of 250 Euros for one small benefit each year. If the cost of the benefit is more than this the exemption does not apply.

F.20 Employer provided accommodation rules seem much simpler.[9]

Expenses

F.21 A flat rate expenses system is in operation. Employers can also reimburse exact costs tax free. There are no reporting requirements for allowable expenses. Employers are required to keep detailed records for six years. Round sum allowances are treated as pay.

F.22 There is no limit on the expenses allowable for removal/relocation as long as they provide no advantage to employee. The procedures are on a self-assessment basis with the employer keeping full records. Moving house must be necessary in the circumstances.

[7] http://www.india-briefing.com/news/payroll-processing-in-india-allowances-and-outsourcing-6224.html/.
[8] http://www.revenue.ie/en/tax/it/leaflets/benefit-in-kind/index.html.
[9] http://www.revenue.ie/en/tax/it/leaflets/benefit-in-kind/subsidised-accom.html.

New Zealand

Benefits

F.23 Employers report the benefits that employees receive as a result of their employment, including those provided through someone else on a fringe benefit tax return.[10] The employer has the tax liability. Employers have to pay FBT on benefits to individuals they no longer employ but are still providing benefits to.

F.24 Benefits such as cars, low-interest loans and free, subsidised or discounted goods and services have their own specific rules for calculating FBT value.

F.25 Payments by way of food, accommodation or farm or cottage board are termed benefit allowances and are taxable.[11] The amount that is taxable is the difference between the market rate for the benefit and any amounts paid by the employees. The value of the benefit is subjected to PAYE.

Expenses

F.26 Home to work travel can be paid tax-free in certain special circumstances, for example working outside the normal hours of work, needing to carry work-related tools and equipment or travelling to fulfil an obligation for the employer.[12] Employers can reimburse employees for on-the-job expenses such as food, mileage or tools.[13] These payments are not taxable if the payment is no more than the actual expense. Employers are allowed to make reasonable estimates or use actual receipts. All these allowable amounts are added to the employee's net salary after PAYE. The amount is not shown on the employer return (IR348) but is recorded in the employer's wage book.

F.27 New Zealand has a similar scheme to the AMAP rates, but with some variances.[14] Like AMAPs the mileage rate paid is the same regardless of engine size or type. For distances over 5,000 miles a year the employee has to keep a record of actual vehicle expenses. They can use a logbook to record their business mileage and after 90 days they work out the average proportion of business to private use for their vehicle.

F.28 Work-related relocation payments are tax free without a limit, provided the payment reflects the actual expenditure incurred.[15] Other conditions and time limits are similar to the UK.

USA

Benefits

F.29 Taxable benefits are subject to income tax withholding and social security.[16] In general the amount the employer must include is the amount by which the FMV of the benefit is more than the sum of what the employee paid for it. The cost incurred by the employer does not determine the FMV. Taxable benefits have to be reported on two different forms. Forms 941 (or Form 944) and Form W-2. Employer can choose the period for withholding and reporting. It can be the pay period, quarter, semi-annual or other basis, but no less frequently than annually.

[10] http://www.ird.govt.nz/fbt/.
[11] http://www.ird.govt.nz/payroll-employers/make-deductions/staff-benefits/allowances/emp-deductions-benefits-allowances-benefit.html.
[12] http://www.ird.govt.nz/payroll-employers/make-deductions/staff-benefits/allowances/emp-deductions-allowances-travel.html.
[13] http://www.ird.govt.nz/payroll-employers/make-deductions/staff-benefits/allowances/emp-deductions-allowances-reimbursing.html.
[14] http://www.ird.govt.nz/business-income-tax/expenses/mileage-rates/.
[15] http://www.ird.govt.nz/payroll-employers/make-deductions/staff-benefits/allowances/emp-deductions-allowances-relocation.html.
[16] http://www.irs.gov/pub/irs-pdf/p15b.pdf.

F.30 Similar to the non-statutory trivial benefits rule in the UK, the IRS allow employers to exclude *de minimis* benefits from the employee's wages. Cash or cash equivalent benefits can never be excluded, except for occasional meal money or transportation fare. A *de minimis* is considered to be any property or service provided to an employee that has so little value, taking into account frequency of provision, that accounting for it would be unreasonable or administratively impracticable. Examples of *de minimis* benefits include holiday gifts with a low FMV, occasional parties or picnics for employee and their guests, occasional tickets for theatre or sporting events.

Expenses

F.31 Employees can deduct work related expenses as an itemised deduction on their return, Form 1040.[17] Employees should use a separate form, Form 2106-EZ to detail their deductions for business expenses and attach it to the form.

F.32 Employers reimbursing expenses under an accountable plan do not need to report them on the employee's Form W-2 and the employee does not need to report them. Reimbursed expenses only have to be reported when they exceed per diems and other set limits. An employer's expenses arrangement must contain the following three rules to be an accountable plan:

- the employee must have paid or incurred expenses that are deductible while performing services as an employee;
- the employee must adequately account to their employer for these expenses within a reasonable time period; and
- the employee must return any excess reimbursement or allowance within a reasonable time period.

F.33 If the requirements are not met the expenses must be reported on Form W-2.

F.34 There are specific rules on home working.[18] The part of the home used must be used exclusively and regularly as their principle place of business. There can be no dual use of rooms. Home based employees may deduct the cost of travelling between their home office and work places associated with their employment.

F.35 The range of allowable relocation expenses is limited and the rules as to whether a move qualifies are restrictive.[19] The new workplace has to a further 50 miles away from the former residence than the current work place.

[17] http://www.irs.gov/taxtopics/tc514.html.
[18] http://www.irs.gov/taxtopics/tc509.html.
[19] http://www.irs.gov/publications/p521/ar02.html#en_US_2012_publink1000203512.

G Termination payments legal background

G.1 This annex sets out the key legislation and HMRC policy which is relevant to the taxation of termination payments. It also outlines some of the complexities of this area which have been highlighted by cases considered by the courts.

Legislation

G.2 A major source of complexity is the interaction between the tax legislation which is specific to termination payments and that which taxes general earnings. This is the case both in relation to income tax and NICs.

Income tax treatment

G.3 Sections 401 to 416 of ITEPA are income tax charging provisions in respect of "payments and other benefits which are received directly or indirectly in consideration or in consequence of, or otherwise in connection with…the termination of a person's employment".[1] However, these provisions only apply to a termination payment if no other charging provision applies.[2]

G.4 In order to determine which charging provision applies to a termination payment, HMRC policy is that the following questions should be raised in the following order, in line with the order of priority which applies to such payments under ITEPA:[3]

- is the payment or benefit earnings from the employment?
- if not, is the payment or benefit for a restrictive covenant?
- if not, and only if no other income tax charge applies, is the payment or benefit made in connection with termination under sections 401 to 416 ITEPA?

G.5 If none of the above applies then the payment is not connected with the termination and therefore is free of income tax and NICs.

Does the payment fall within general earnings?

G.6 "Earnings" is defined under section 62 ITEPA as including "any salary, wages or fee, any gratuity or other profit or incidental benefit of any kind…or anything else that constitutes an emolument of the employment".

G.7 Due to this wide definition, it is often the case that a termination payment will be taxed as earnings under section 62 ITEPA instead of being subject to section 401.

G.8 The one exception to this rule is redundancy payments, which are taxed under section 401, even where provided for under the employment contract, provided that they are made genuinely

[1] Section 401 also extends to payments and benefits on a change of duties or change in earnings, but such payments would ordinarily be taxed as earnings in practice, for the same reasons described above in relation to termination payments.
[2] Section 401(3) ITEPA.
[3] HMRC Employment Income Manual EIM12810.

on account of redundancy.[4] An employer operating a redundancy scheme is able to apply to HMRC for specific clearance that the redundancy payments will be taxed under section 401. However, this type of clearance procedure is not available in relation to other forms of termination payment.

Is the payment for a restrictive covenant or does it fall within another charging provision?

G.9 If an employer pays its employee on termination in return for the employee agreeing to new restrictions (for example that he will not act in competition or solicit customers or employees), this payment will be fully taxable under sections 225 and 226 ITEPA and subject to NICs.

G.10 Various other charging provisions may apply to a termination payment, depending upon the nature of the payment itself. Specific rules apply to the taxation of shares and rights to shares, as well as payments in respect of pension schemes and employer financed retirement benefits schemes. Any payments made by a third party may potentially be taxable in full under the "disguised remuneration" legislation in Part 7A of ITEPA 2003, which imposes tax on certain payments made by third parties other than the employer or a member of its corporate group.

Operation of Sections 401 to 416 ITEPA

G.11 Subject to the above, if a payment or benefit does fall within section 401 ITEPA, the first £30,000 of its value will be tax-free and any excess above the £30,000 threshold will be taxed as employment income in the normal way. See the end of this Appendix for a note of how this threshold has increased over time.

G.12 Sections 401 to 416 also include tax exemptions from certain types of termination payment. Broadly, these are:

- certain employer contributions to approved personal pension schemes before 6 April 2006 or to registered pension schemes and employer-financed retirement benefit schemes[5];
- payments or benefits provided in connection with the termination of employment on death of the employee, or on account of injury to or disability of an employee[6];
- payments or benefits provided under certain tax- exempt pension schemes[7];
- certain payments in respect of employee liabilities and indemnity insurance[8];
- certain payments and benefits for the forces[9];
- certain payments made by foreign governments[10];
- payments or benefits made in certain cases of foreign service (in which case a full or partial exemption may apply) [11]; and
- payments for certain legal costs in connection with the termination[12].

[4] section 309 ITEPA and HMRC Statement of Practice 1/94.
[5] sections 405 and 408 ITEPA.
[6] section 406 ITEPA.
[7] section 407 ITEPA.
[8] sections 409 and 410 ITEPA.
[9] section 412 ITEPA.
[10] section 411 ITEPA.
[11] sections 413 and 414 ITEPA.
[12] section 413A ITEPA.

NICs treatment

G.13 NICs are payable in respect of any "earnings" received by "employed earners" from their employment[13]. Following case law on this area, HMRC policy is that this includes earnings from previous employment.

G.14 For NICs purposes, "earnings" includes "any remuneration or profit derived from an employment".[14] HMRC policy is that when determining whether a payment is "earnings" for NICs purposes, the principles established for income tax in relation to emoluments will apply. For NICs, a payment will still be earnings if it derives from the employment,[15] but if it is compensation paid in settlement of a claim for damages for breach of contract then it will not be.

G.15 Therefore, for both income tax and NICs, the meaning of earnings is broadly similar and most items that are earnings for income tax purposes are also earnings for NICs purposes.

Different income tax and NICs treatment for payments falling under section 401

G.16 As outlined above, if a payment is not general earnings and it is not taxed under any other income tax charging provision then it will fall under section 401 and be subject to income tax to the extent that it exceeds £30,000. Payments of this kind which exceed £30,000 will therefore have a different income tax treatment and NICs treatment: only the amount which exceeds £30,000 will be subject to income tax, but the whole of the payment will be free of NICs on the basis that it does not constitute "earnings".

Difficulties which arise under this tax regime

Identifying the different elements of a termination package

G.17 A termination payment can often consist of a variety of different elements, such as payment in lieu of notice, restrictive covenant payment, compensation for loss of office, unpaid salary, and non-cash benefits provided after termination, payments into a pension scheme. When determining its tax treatment, each element must be separately identified, and then the circumstances and the basis for it being included in the termination payment must be considered in order to confirm which charging provision applies. Employers often fail to appreciate this when drafting the compromise agreement which sets out the terms of the termination payment. Problems often arise:

- if each element of the termination payment is not clearly identified in the compromise agreement: In these circumstances it is possible that the payment will be fully taxable as earnings, without taking account of the background in which the payment is being made[16]; and
- if the payment is described in a particular way in the compromise agreement: If the payment is described in a particular way in the compromise agreement then this can inadvertently impact on its tax treatment, even where the contractual position is not clear[17].

[13] section 6(1) of the Social Security Contributions and Benefits Act 1992.

[14] section 3(1) of the Social Security Contributions and Benefits Act 1992.

[15] NIM02610. Note, however, that a redundancy payment is free of NICs under regulation 25 and paragraph 6 of Part X of Schedule 3 to the Social Security (Contributions) Regulations 2001.

[16] Reid v HMRC {2012] UKFTT 182 and Johnson v HMRC [2013] UKFTT 242.

[17] Goldberg v HMRC [2010] UKFTT 346.

Determining whether the termination payment constitutes "earnings"

G.18 As a general rule, a termination payment will be treated as "earnings" if it satisfies a right to remuneration in the employment contract or is otherwise an emolument of the employment. In such cases the termination payment will therefore be subject to income tax and NICs in full under section 62, rather than being able to benefit from the £30,000 exemption under section 401 and the associated NICs free treatment.

G.19 Even where the employment contract provides for a payment on termination "for any reason" then the payment is treated as earnings rather than compensation for the termination.[18] However, if instead the payment is damages paid in compensation for a breach of the contract then it should not be earnings and should be subject to section 401. The distinction between these two types of payments is not always clear. Particular difficulties have arisen in resolving the following questions:

- does the payment satisfy a right to remuneration in the employment contract? Where it is unclear what the payment represents or the basis upon which is has been calculated, the courts have had to consider whether or not it was paid as a result of a right under the employment contract[19]; and
- what does the employment contract consist of? In establishing whether the payment satisfies a right to remuneration in the employment contract, it is necessary to identify what the contract itself comprises of. This is not necessarily clear, as the contract may have been amended or supplemented over time, or it may be set out in a number of different documents, depending upon the processes followed by the employer in dealing with their employees' terms.[20] HMRC takes the view that the contractual arrangements between employer and employee can extend to a variety of different documents. Many employers are unaware of this.

Treatment of payments in lieu of notice (PILONs)

G.20 Employers often terminate the employment immediately by making a PILON instead of giving the full period of notice, and the tax treatment of this type of payment can raise particular difficulties. If it is made under an express provision in the employment contract then it is taxable as "earnings", for the reasons referred to above. However, if it is not expressly provided for in the contract then the courts have found that its tax treatment is less clear, particularly on the following issues:

- is a discretionary PILON treated as a contractual payment? If the employment contract expressly gives the employer discretion to make a payment in lieu of notice, and the employer makes such a payment, then the courts treat the payment as taxable earnings arising from the contract.[21] However, the position is less straightforward where the employer has not exercised its discretion to make the payment and has paid damages instead, as a payment of damages may be taxable under section 401. In those circumstances, HMRC tends to treat the payment as

[18] Dale v De Soissons (1950) (32TC118.
[19] Carter v Wadman (28TC41) 1946.
[20] For example in SCA Packaging Limited v HMRC [2007] EWHC 270 (Ch) it was decided that a memorandum between the employer and trade unions representing its employees formed part of their employment contract.
[21] EMI Group Electronics Limited v Coldicott (HMIT) (1999)(71TC455).

taxable earnings unless there is clear evidence of it being a damages payment.[22] In practice, this can be very difficult for an employer to demonstrate.

- **is the PILON treated as a contractual payment as a result of custom and practice?** HMRC argued in the past that if an employer has made such payments as a matter of custom and practice then they will generally have resulted in an implied contractual right to receive a PILON, which is therefore taxed as if it had been expressly provided for in the contract.[23] The courts have held that in fact the threshold is high for custom and practice to imply terms into employment agreements.[24] HMRC changed its view on this issue in 2003 on the basis that contracts generally include a right to receive notice (either expressly or through statute) and therefore an implied right to receive a PILON would conflict with this.[25]

- **is the PILON treated as a contractual payment because it is made automatically?** HMRC now considers that if the employer makes a PILON as "an automatic response to a termination" (often referred to as an "auto-PILON") then it can still be taxable as earnings unless the employer has a procedure for making a genuine "critical assessment" in the making of such payments, so that they are not made automatically.[26] Whilst HMRC continues with this policy, a risk remains for companies who are unable to demonstrate that they operate a "critical assessment" procedure in the making of PILONs in these circumstances. HMRC itself has confirmed that it would like to see legislation to clarify how these types of payments are taxed.[27]

Determining the treatment of payments which are not "earnings"

G.21 As referred to above, payments will only be taxable under section 401 if they have been received in connection with the termination and are not chargeable under any other section. The payment must be made "directly or indirectly in consideration or in consequence of, or otherwise in connection with the termination". The courts have found that the words "otherwise in connection with" under the legislation should be interpreted very widely and can mean "in any way connected with".[28] As a result, many payments which might otherwise appear unconnected with the termination itself will nevertheless be subject to tax under section 401. Employers are often unaware of this and therefore do not anticipate that there will be tax due on the payment to the extent that it exceeds £30,000. Tax can therefore be due on various types of payments, including:

- **payments for distress or damage to reputation:** Unfair dismissal awards are taxed under section 401 on the basis that they are received in connection with the termination of employment. If compensation is paid to an employee, for example for damage to reputation, as part of a payment to settle unfair dismissal claims, the courts have found that this is directly connected to the termination of his employment and, therefore, is subject to tax under section 401.[29]

[22] For example, there would need to have been a clear breach of contract by the employer (which justifies the payment of damages) and the payment should have other characteristics of a damages payment, such as being calculated so that adjustments should be made to reflect the difference in tax treatment between earnings from employment and a damages payment.
[23] Corbett v Duff (1941) 23 TC 763.
[24] Clinton v HMRC [2009] UKFTT 337 (TC) and SCA Packaging Limited v HMRC [2007] WEHC 270.
[25] HMRC Tax Bulletin 63.
[26] HMRC Employment Income Manual EIM12977.
[27] See Tax Guide 3/11 of the Institute of Chartered Accountants in England and Wales.
[28] HMRC v Colquhoun [2010] UKUT 431 (TCC).
[29] A v HMRC [2009] UKSPC SPC00734.

- **payments in relation to discrimination:** The courts have found that a compensation payment made by a tribunal or under a settlement agreement to an employee for discrimination may be taxable under section 401 if the discrimination is the cause of the termination of the employment, but only to the extent that the compensation meets financial loss caused by the termination of the employment.[30]
- **gifts:** Due to the wide drafting of section 401 the courts have had difficulty in finding that a cash gift made on termination will not be considered to be received in connection with the termination of employment, and therefore it will be taxable under section 401.[31]

History of the £30,000 exemption

G.22 Following its introduction in 1960, the value of the exemption was increased steadily over the next two decades, but it has now remained the same since 1988. A summary of its increases is as follows:

- 1960: introduced at £5,000[32];
- 1978: increased to £10,000[33];
- 1981: increased to £25,000[34]; and
- 1988: increased to the current level of £30,000[35].

[30] Oti-Obihara v HMRC [2010] UKFTT 568 (TC).
[31] Resolute Management Services Ltd v HMRC [2008] UKSPC SPC00710.
[32] Section 37, Finance Act 1960.
[33] Section 24 Finance Act 1978.
[34] Section 31 Finance Act 1981.
[35] Section 74 Finance Act 1988.

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ISBN 978-1-909790-26-1