

Autumn 2012 Newsletter

In our Autumn newsletter we provide details of recent topical developments, including details of the government guidance on 'off-payroll' workers, and updates to the RTI proposals.

Employment status and IR35

State sector employers are now expected to implement recent Cabinet Office recommendations to ensure that all senior staff are placed on the payroll. In addition formal assurances must be sought about the tax affairs of contractors if they earn more than £220 per day and their contracts last more than 6 months. For self-employed workers, departments must refer to HMRC's published Employment Status Indicator (ESI) tool to verify the worker is correctly treated as self-employed (see: <https://esi2calculator.hmrc.gov.uk/esi/app/index.html>).

However for limited company contractors, the guidance ties in with HMRC's 'business entity tests' for IR35 issued in May this year. Unless the contractor can show they are 'low risk' (using HMRC's arbitrary business entity 'points scoring' process), they will be obliged to provide evidence to the engager that they are outside IR35 (e.g. following a contract review by HMRC's 'independent' IR35 helpline), or to positively demonstrate that IR35 obligations are being fully met i.e. that PAYE/NIC is being accounted for. Engagers who are unable to obtain such confirmation from the contractor are advised to terminate the engagement.

Outside the public sector, many contractor forums do express concern that HMRC apparently intends to enforce the IR35 rules more rigorously in the future, although we have not seen any significant evidence of this, so far. The IR35 rules have not changed, and only apply where the engagement would be that of employer-employee, but for the interposition of the personal service (or other limited) company. Whilst any immediate IR35 risk falls on the limited company receiving the fees, few hiring businesses would welcome the potential for workers to gain unexpected employment rights. Therefore if appropriate, all parties should work to ensure that 'self-employed contracts' of engagement do work in practice as well as on paper.

Real Time Information (RTI)

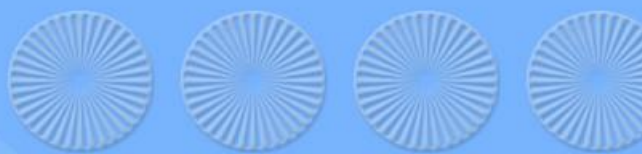
Whilst RTI will not affect the way in which PAYE or NIC is calculated, it is a very significant change in the way in which PAYE/NIC deductions will be reported to HMRC. Annual return forms P35 and P14 will be abolished, and the employer will instead be obliged to make an RTI return after every payroll run.

Given that the new RTI process will be mandatory for most employers in *under 6 months* time, it was appropriate that HMRC's September 2012 Employer Bulletin included a detailed update on these matters. In particular, there is a reminder that all employers not already included in the pilot scheme will have to go through a 'Payroll Alignment' process, prior to commencement of RTI reporting (i.e. this is an initial check to ensure that the employee information you hold matches that held by HMRC). There is also a useful summary on common 'data error' issues (mainly where employee full names, dates of birth, or NI numbers, are either wrong, missing or incomplete).

Although the Bulletin does read like a 'party political broadcast on behalf of the RTI party', it is necessary to take the overt optimism with a pinch of salt. Despite HMRC assurances that RTI will be 'easier', the very fact that employers must make an accurate RTI return after every payroll run will inevitably involve additional time and effort. However the automatic inclusion of starter and leaver notifications within the RTI process is a positive step, which should reduce employer work in the long run, and ensure that that HMRC's own records are automatically kept more up to date.

Car or van?

HMRC has recently issued updated guidance to assist in the often difficult distinction between a car and a 'commercial vehicle' such as a van. For instance in a vehicle which looks similar to a car from the outside, the guidance says that adaptations must give it the overall functionality of a commercial vehicle to be treated as such, e.g. it is not enough to just take out the back seats, it must be quite unsuitable for carrying passengers in the rear. However for other vehicles which have the external appearance of a van (whether or not they have rear seats), their treatment is



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more likely to be determined by either a 'payload' test (i.e. can they carry more than one tonne, after any seats are fitted) or whether the 'dedicated load area' is larger than the passenger area.

Whilst the guidance is intended to primarily address VAT issues, in most cases (e.g. including 'double cab pick ups') HMRC will usually apply the same VAT distinctions to the benefits in kind legislation, which is generally more favourable toward commercial vehicles rather than cars.

Therefore with proper initial identification of vehicles as either 'cars' or 'vans', then by implementing effective policies and monitoring for both cars and commercial vehicles, employers can manage and minimise their own and their employees' tax and NIC costs.

Variable salary sacrifices and dispensations

Salary sacrifice must create an ongoing defined change to contractual income in all cases and, with one or two exceptions such as those implemented in conjunction with approved childcare, the change must normally last for a specified period. Therefore, variable salary sacrifices i.e. where the sum sacrificed can be altered on a frequent and regular 'pay day by pay day' basis, are, in HMRC's opinion, unlikely to be tax compliant.

There are two main reasons why salary sacrifice may be legally ineffective for tax purposes; it may be argued that the contract has never been changed in the first place (i.e. the sacrifice may be too 'loosely worded' to change the contractual salary entitlement), or that an ongoing right to convert back to salary creates 'money's worth' in the employee's hands. However a further consideration, as amplified in a recent statement from HMRC, is that employers are unlikely to be able to rely on dispensations issued to cover tax-free 'scale rate expenses' payments, where the expenses are paid in conjunction with a variable salary sacrifice.

Whilst the HMRC guidance seems correct in principle, it may be an over-simplification in some cases. The effectiveness of *all* dispensations entirely depends on the 'circumstances as stated' to HMRC, in particular whether the employer has placed all their cards face up on the table. However the First Tier Tribunal decision in Reed Employment Plc v HMRC (announced in January 2012) did provide a stark warning of the risks involved if HMRC decides it is appropriate to withdraw a dispensation retrospectively - in effect (and subject to any appeal) requiring the employer to account for substantial arrears of PAYE/NIC over many years.

Trivial benefits

Recently updated HMRC guidance reminds us that trivial benefits, usually items of a 'staff welfare' nature or small seasonal gifts, and which are not provided as a reward for particular services, can be regarded as exempt rather than be returned on forms P11D or the annual employer's PSA. There is no formal definition of the term 'trivial' therefore agreement should be sought with HMRC in areas of doubt. However the materiality of the provision should be considered in relation to the individual item(s) of expenditure rather than total cost for the employer.

HMRC drops PAYE Pooling plans

In October 2011 HMRC advised it was consulting on whether to introduce rules which formally permit closely connected employers to operate a single pooled PAYE reference. However as a result of other priorities (e.g. RTI) the proposal has been now put on ice. The important point to note here is that HMRC says 'no new applications to pool payrolls will be accepted' in the meantime. In truth there is already some degree of PAYE pooling in many (if not most) group company situations. Therefore for instance if seeking to transfer employees into a consolidated payroll (e.g. if those TUPEd in from a group acquisition) some HMRC resistance may now be encountered.

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