

## OTS recommendations – a whole new ball game, or tinkering with the rules?

At the end of last month the Office of Tax Simplification (OTS) published its eagerly anticipated [Second Report](#) into the tax treatment of Employee Benefits and Expenses.

The OTS recognises that employers spend a large and disproportionate amount of time interpreting and administering some very complicated rules, in order that taxable benefits may be correctly calculated and reported. Not everyone will wish to read all 86 pages of the Report, but the fundamental questions addressed boil down to two things; can interpretation and administration of the rules be made any simpler, and can HMRC do more to help employers in their (sometimes reluctant) role as informal 'tax assessor and collector'.

Taxation of fringe benefits was originally introduced in the post war years, and was then substantially overhauled in the mid 1970s. The current format of the form P11D therefore goes back to the time when employers were looking to introduce novel ideas to overcome government wage freezes, and (as ET4B has the misfortune to remember) literally everything in the Inland Revenue department was written down on paper. However, just because something has been with us for over 60 years, doesn't mean it should stay with us for another 60!

Amongst some fairly significant changes proposed by the OTS, the main ones are as follows:

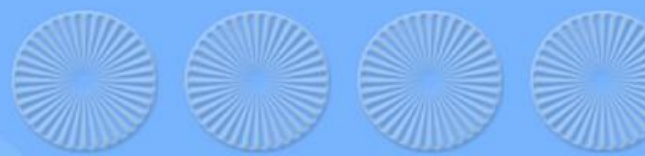
- HMRC should actively encourage employers to voluntarily payroll benefits, thus negating the annual P11D requirement. Earlier HMRC consultations on this theme had fallen by the wayside, as they had proposed compulsory payrolling based on current rules, i.e. merely converting an annual employer requirement to an ongoing 'real time' one (in effect a 'stick without a carrot' approach). The OTS believes that by HMRC taking steps to actively encourage and facilitate voluntary payrolling of benefits (for instance permitting corrections etc for benefit changes to be implemented within 3 months of the change) this would, in time, lead to a reduction in annual forms P11D, potentially of up to 99%.

A further OTS recommendation would be a legislative P11D exemption for benefits which had been fully taxed and NIC'd via payroll. We agree that the current requirement for employers to report a NIL benefit in such cases is an unnecessary burden to employers and of no use to HMRC (as far as we can tell, at best the Department simply 'files away' any such reports).

- The scope of PAYE Settlement Agreements (PSAs) should be widened. The PSA is easily the simplest route by which employers can account for the tax and NIC on benefits (albeit it is an expensive one). It is also by far and away the easiest method by which HMRC may collect this tax and NIC, on a grossed up basis. With this in mind it is difficult to reconcile HMRC's approach in recent years of actively seeking to limit what employers may or may not include within a PSA. It would come as no surprise to us if, for every £1 HMRC 'loses' in the PSA process (including reduced employee's NIC, in some cases), it gains at least £10 in the PSA's ease of collection and grossing up methodology.

ET4B appreciates there are some genuine reasons for limiting the scope of PSAs. For instance, permitting employers to decide if income should be excluded from their employees own tax return or P60 does provide some (albeit limited) potential to manipulate certain rules (examples could be if the employee qualifies for income-based state benefits, or would be subject to Personal Allowance tapering on income over £100,000). The suggestion by the OTS, that PSA relaxation should merely be subject to the proviso that there is no intent to abuse the rules, may prove to be an 'optimistic' one, and any anti-avoidance measure may be counter to its aim of simplification.

In addition to widening of the PSA's scope, the OTS recommends that an online PSA return completion process should be introduced, and that "in the era of self assessment" the current need for employers to 'apply' for a PSA should be abolished completely.



- A clearer definition of certain benefits would be a corollary to the wider PSA scope. One example would be to clarify definitively what constitutes a 'trivial' benefit, including perhaps a fixed upper limit (e.g. £50). There was never any HMRC intention to permit exemption for payments whose motive was a genuine reward for work done (as opposed to recognition of personal circumstances e.g. on bereavement or childbirth etc), and the OTS recognises that only trivial benefits provided 'infrequently' would fall within any statutory definition.
- Dispensations could be replaced by a statutory exemption for allowable business expenses paid for or reimbursed by the employer. For many P11Ds it would seem that the tax at stake is outweighed by the administrative burden in reporting and collecting it, indeed the OTS comments that 1 in 8 forms P11D are completed for values under £100.

In principle, there is no reason why every employer should not be permitted to exclude allowable expenses from P11Ds, so long as certain minimum requirements are met. Of course employers would still need to know which expenses were allowable and which weren't; but the introduction of a statutory exemption for allowable expenses would mean for instance that employers need not necessarily have to reapply for updated dispensations every few years (which is currently the case).

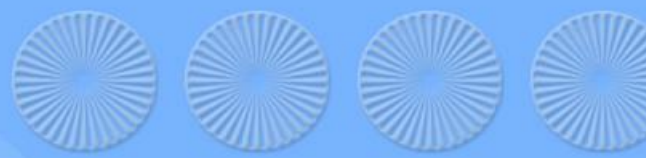
If this concept were considered too radical, a suggested alternative from the OTS would be for HMRC to issue an across the board dispensation; i.e. in effect make a unilateral declaration that a dispensation would always apply to every employer which meets certain (HMRC published) necessary policy and procedural standards.

- Abolition of the £8,500 'higher paid' P11D threshold. When the current limit was introduced in the late 1970s, £8,500pa represented 150% of average earnings. Currently it represents 35% of average earnings, and it is now dwarfed by Minimum Wage for all full time staff. The OTS notes that in practice most employers simply ignore the limit, so there is a strong case for its dissolution. However there are of course a number of (mostly part time) employees who still fall below this limit and where an immediate change could increase their or their employer's tax burden (particularly as regards accommodation provided, and smaller incentive type awards). Therefore it would be necessary to ensure the impact of any such changes is appropriately mitigated. One option suggested by the OTS would be for bespoke exemptions to be introduced, on items such as carers' or ministers' accommodation.

It is difficult to argue with the logic that the current system of taxing certain benefits differently, depending on this arbitrary limit, is due an overhaul.

- Simplification of Travel and Subsistence and other expenses deduction rules. The HMRC booklet 490 contains many detailed yet (sometimes) contradictory examples, and the need for its update is reflected in the OTS report. There were a number of different suggestions, as follows:

- One issue is the current HMRC view (as expressed in booklet 490) that employees may have *two (or more) concurrent* permanent workplaces, without really establishing objective tests to determine all such cases. To take things forward, the OTS suggests that the employee might be designated as having one permanent workplace only. If this were not possible, a permanent workplace might be determined by a statutory test if the employee spends a set percentage of their time at that place (the OTS document proposes 30%, whereas the current equivalent HMRC informal guideline percentage is 40%).
- Furthermore, the rule which says employees may only attend a temporary workplace for up to two years would now cover a finite period (i.e. a mere change of intention within the two year period would not alter the tax reliefs due for that two years, so long as the longer term intention of the secondment etc were a temporary one).
- The OTS recommends that subsistence deductions be clarified and that accommodation provided whilst on necessary travelling would be exempted or dispensed.
- Additionally the OTS would wish to more clearly define 'homeworkers' and the allowances which are appropriate in these cases.



# Employment Tax for Business

- There is a recommendation that Flat Rate Expenses (FREs) deductions should be upgraded, raising limits that have become unrealistically low, and abolishing any that have become outdated.

Whilst the OTS paper initially indicates that on balance employers would prefer to stick with the current travel relief regime (as introduced in 1998), the possibility of longer term and more significant change is also debated. One of these more radical ideas would be to define allowable expenses by reference to what the employer deems necessary (any non-reimbursed expenses therefore being non-allowable). The effect here could be quite significant and potentially unfair, to employees of less generous employers.

- Simplifying NICs generally. The long term aim remains to fully align the income tax and NIC systems; however the OTS does recognise this would present very significant challenges. One example of this (obvious to ET4B at least) would be employees engaged on international travel, as most other countries do currently have separate tax and social security systems, and separate exemptions and reliefs to prevent double taxation (or social security) arising.

Therefore other perhaps more realistic and gradual measures have been suggested. For instance there are suggestions for making the tax and NIC rules for calculating benefits identical (there are a number of contradictory examples currently, such as where a mixed business and private use asset is provided to an employee), and harmonising the day to day tax and NIC calculation rules (i.e. perhaps making NICs 'cumulative' rather than calculated on individual earnings periods throughout the year).

One other possibility suggested would be the complete abolition of Class 1A NIC on benefits (i.e. so that all benefits attract Class 1 employees and employers NIC). Again this would be an additional cost, and even when weighed up against the administrative savings achieved, this may not be a roundly popular idea.

So what happens next? These are only ideas at this stage, and fans of Yes Minister will note that there is more to achieving change than setting up a few committees. However the OTS Report does seem to be even-handed i.e. also recognising most of what HMRC would regard as hurdles to be overcome; and initial noises from within the Revenue suggests there is an appetite to react positively. In the short term, we think we can expect action which focuses on 'quick wins' and perhaps matters which do not require amendment of primary legislation.

Longer term there may of course be costs (for employers and/or individuals) as well as savings in some of the more significant areas. In that respect clearly any changes cannot be rushed. However the report has to be commended in encouraging closer review of the bigger questions as part of taxation policy making. There is no doubt that the expenses and benefits legislation has evolved piecemeal and the time is ripe for an update.

Substantial changes may not happen overnight and so employers must continue to meet their existing ongoing obligations. At ET4B we pride ourselves in being able to abbreviate these complex matters significantly, translating these into plain English and simple guidelines, whilst of course keeping a close eye on possible future changes. If you feel ET4B can assist your own organisation in this rapidly changing environment please do not hesitate to contact us.

**Brian Ackerley:** 07712 527355

**Dave Cooper:** 07833 218569

**Email:** [brianackerley@et4b.co.uk](mailto:brianackerley@et4b.co.uk)

[davecooper@et4b.co.uk](mailto:davecooper@et4b.co.uk)

**Website:** [www.et4b.co.uk](http://www.et4b.co.uk)

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