

A Call for evidence on remuneration practices

Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive summary

- 1.1 The LITRG welcome the opportunity to respond to this call for evidence on remuneration practices – we are responding to it on behalf of low paid workers.
- 1.2 Low-paid employees in unskilled jobs are generally rewarded in cash. Despite the lack of complexity in their ‘packages’, their pay and conditions are still affected by tax and National Insurance contributions (NIC) rules and vice versa.
- 1.3 In this response to the call for evidence we present a summary of some ‘difficult’ aspects of low level remuneration which we think tax policy makers should know about, together with recommendations as to how changes to the tax system may help to overcome them, for example:
- A problem with the National Minimum Wage (NMW) and unreimbursed travel expenses means that low paid workers can actually earn less than the base rate. Ideally this imperfection would be dealt with via a change to the NMW legislation, however as it involves a complex interaction with the tax system, it seems to us that a change in the tax rules could also help improve the position of affected workers.
 - The recent trend in ‘underemployment’ means that the low-paid can work such few hours that they do not meet the Lower Earnings Limit of £111 per week. We therefore urge policy makers to consider how to help low paid workers access the NIC and benefit system.
 - Continuing problems for agency workers getting caught up in travel and subsistence schemes leads us to recommend changes in the outdated temporary workplace rules. This would provide them with relief for their, often significant, travel costs, and would remove the incentive for many of the ‘schemes’ from the labour market – saving considerable effort all round.
 - Because of underlying fault lines in the tax system, oversights as to the timing or structuring of certain pay elements by an employer can mean the worker loses out. We give the

example of tips, where we ask for consistent tax and NIC treatment regardless of how the tip reaches the worker, and holiday pay, where we recommend exploring the possibility of Real Time Information and the sophisticated payroll programs of today to ease cash flow for employees on low pay.

- 1.4 We acknowledge the efforts of the Office of Tax Simplification (OTS) in bettering our tax system, but fear these specific difficult areas, of which there are many, may fall through the cracks. We hope our evidence and recommendations may eventually lead to policy changes that improve the standard of living and wellbeing for those in low paid work. We would like to state our readiness to do whatever we can to assist the Government further in this.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

- 3.1 We welcome the opportunity to respond to this call for evidence on remuneration practices.
- 3.2 The call for evidence paper seems to make a general assumption that employees are valued and rewarded – with remuneration packages made up of several components, negotiated with a view to staff retention and incentivisation. This may well be true for some, but is far less likely to be the case for the one in five UK workers who are low paid¹, perhaps vulnerable and who may well be struggling with in-work poverty. While not all low-paid jobs are 'bad', they are less likely than higher-paid jobs to demand skills or qualifications, meaning few low-paid workers will have any bargaining power or a say in how they are rewarded.
- 3.3 Low-paid employees in unskilled jobs are generally rewarded in cash². There is no need for fringe benefits or other perks to attract them into roles (indeed, with their focus on meeting day-to-day living expenses, it is questionable whether workers would prefer them to higher cash pay even if they were offered).

¹ <http://www.resolutionfoundation.org/publications/minimum-review-minimum-wage-final-report/>

² By 'cash', we do not mean cash in hand – we mean that the worker receives no 'in kind' remuneration.

- 3.4 Nevertheless we do not think those at the bottom of the wage scale should be overlooked in this review. Despite the lack of complexity in their ‘packages’, their pay and conditions are still affected by tax and NIC rules and vice versa. We are therefore responding to this consultation on behalf of low-paid workers. We are concerned that the likely profile of respondents to this call for evidence may otherwise only give part of the true picture. This is particularly the case given that the employers who respond are likely to be those concerned for the welfare and proper reward of their staff, so when considering the responses, the Government needs to consider this likely imbalance of representation.
- 3.5 We present a summary of some ‘difficult’ aspects of low level remuneration which we think tax policymakers should know about, together with recommendations as to how some changes to the tax system may help to overcome them. These have been organised into the four broad areas that the Government is interested in.
- 3.6 There are other areas of concern which could form a future consultation topic all of their own. The different ways of treating remuneration under the tax, tax credits and welfare benefit systems can create both work incentives and disincentives, and make an impact on Government finances. We recommend that the Government consult further on these interaction complexities as part of the follow-up to this initial call for evidence.
- 3.7 For the purpose of this exercise, the ‘evidence’ presented has come to us in the course of our work, liaising with other voluntary sector organisations, and from members of the public who have written to us about their experiences via our website.

4 LITRG evidence

Section 1 – What different forms of remuneration make up remuneration packages?

- 4.1 Despite the efforts of certain organisations³ to encourage low-paying employers to adopt employee-friendly remuneration practices, such as the introduction of benefits that could help to improve working conditions and ability to work (for example, facilitating childcare), the majority of low-paid employees are rewarded for their labour mainly with cash – typically in accordance with the number of hours they work.
- 4.2 For these workers, their hourly pay tends to be at or around the NMW. However for some workers, a certain employer practice permitted by an imperfection in the NMW legislation means that they actually earn less than the base rate. Ideally this imperfection would be dealt with via a change to the NMW legislation, however we appreciate that this would have wider implications and would need to be carefully considered. In the meantime, as the ‘imperfection’ involves a complex interaction with the tax system, it seems to us that a more targeted change in the tax rules could help improve the positions of affected workers. We explain this further in para 4.3 below.
- 4.3 ***Unpaid travel expenses***
- 4.3.1 Earlier this year, the LITRG published an article (appended) which discussed the difficulties faced by care workers who provide home care. They might, for example, work for private organisations commissioned by local authorities and therefore are paid out of public funds. Despite having an

³ For example, Joseph Rowntree foundation.

average hourly rate just 15% above the NMW⁴, to meet client demand, care workers' fragmented rotas often translate to 'rushed' visits around peak times with long gaps spent at home which they are not paid for. They are not paid for the time spent 'on the road' to and from appointments and home, nor reimbursed the costs of such travel. Today's road fuel prices mean these involuntary journeys involve significant cost to the workers relative to their already limited budgets.

- 4.3.2 For NMW purposes, the unreimbursed costs of such travel do not factor in the calculation as they are not classed as being 'in connection with the employment'⁵. While an amendment to the NMW legislation that came into force in January 2011⁶ means that any home to work costs that are reimbursed cannot count towards pay (thus defining NMW pay for those with reimbursed travel expenses as the base rate plus travel costs), no such allowance is given for expenses which the employer does not reimburse and which are met by the workers out of their own pay.
- 4.3.3 Yet these costs are considered allowable 'temporary workplace' travel for tax purposes. Often care workers are told in their induction that their home to work and client-to-client travel expenses will be 'covered' by HMRC's Authorised Mileage Allowance Payments system (AMAP). For the workers, many of whom lack even a broad understanding of the tax system, it is a shock to discover that AMAP system does not actually pay them 45p a mile and only gives them tax relief on it. For others, AMAP is totally meaningless, as being able to claim tax relief depends on there being a tax liability in the first place, which for the very lowest paid care workers is often not the case. This is particularly so given recent years' above-inflation increases in the personal allowance.
- 4.3.4 Recommendation: we wonder whether the AMAP rules could be re-thought, perhaps allowing some form of employment mileage 'loss' relief for such workers. It seems only fair that the tax system recognises their difficult working conditions even if the NMW rules do not.
- 4.3.5 There is a broader point to be made about lack of balance in the tax system for those who do not have their expenses paid or reimbursed by their employer. It is unfair that some expenses are permitted tax relief in instances of reimbursement, but are denied a corresponding deduction in instances of non-reimbursement (for example incidental overnight expenses and passenger payments). Additionally, where tax relief may be claimed even if the expenses are not reimbursed, there is no NIC deduction for that expense.
- 4.3.6 For example, if an employee travels 100 miles in his own car to a work conference carrying a fellow worker, then he can be reimbursed £50 tax and NIC free⁷ by his employer (essentially saving a basic rate tax payer £16 in tax and NIC). However, another employee in exactly the same circumstances who is not reimbursed, can only make a tax deduction claim for the £45 mileage and this would only be a tax claim, not a tax and NIC claim (saving him £9). He is therefore £12 worse off. These unfair anomalies are one of the main reasons for the OTS's recommendation that a review of the underlying rules is undertaken with a view to aligning them as far as possible⁸, which we wholeheartedly agree with.

⁴ Per page 21 of a research report for the Low Pay Commission:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227614/LPC_-_Final_Leeds_University_Report_-_26_February_2013SM2.pdf.

⁵ <http://www.legislation.gov.uk/ukxi/1999/584/regulation/32/made>

⁶ <http://www.legislation.gov.uk/ukxi/2010/3001/regulation/2/made>

⁷ 45p per mile for his mileage and 5p per mile for the passenger

⁸

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OTs_employ_ee_benefits_final_report.pdf.

Section 2 – Why are different forms of remuneration used?

4.4 Market pressures and a ready labour supply encourage employers to employ in ways that minimise labour costs. This means those in low-paid employment have little prospect of remuneration packages tailored to meet their preferences. Not wanting to be undercut by competitors, decisions about their remuneration are made wholly by the employing business – probably with a view to offering the cheapest terms possible rather than incentivisation, job satisfaction and employee welfare.

4.5 We feel that the above factors and a desire to reduce labour costs even further have contributed to increases in the prevalence of ‘non-standard’ employment, such as contracts involving variable, part time or zero hours, and temporary, casual or agency work.

4.6 *Variable, part time and zero hours arrangements*

4.6.1 Dividing full time hours over two or more workers through the use of these types of contract can help employers to reduce their secondary National Insurance costs. There is also an incentive (for small and micro employers at least) to ‘under-employ’ staff so as to keep their earnings below the thresholds at which ‘extra’ employer costs are variously triggered. For example, statutory sick pay is only payable where average weekly earnings are more than the Lower Earnings Limit (LEL)⁹ and for workplace pensions, in 2014/15 ‘auto-enrolment’ only kicks in once annual earnings reach £10,000.

4.6.2 Such forms of ‘flexible working’ mean financial insecurity for employees, eroding their precarious positions yet further. But low weekly earnings can have other, more unexpected consequences for workers from a tax and NIC perspective. In our recent submission on zero hours contracts¹⁰, we noted one part of the system that seemed to put workers at a particular disadvantage – having to meet the LEL¹¹ in order to qualify for welfare support such as:

- The state pension – from 2016 a full state pension will require 35 qualifying years of NIC payments or credits.
- Contribution-based benefits, such as Jobseekers’ Allowance.

4.6.3 Recommendation: Meeting the LEL may be achievable for most workers in a single, full time job with the NMW as it stands. But workers who, say, have two part time jobs, each being 16 hours at the NMW, would not meet it. We would therefore urge policymakers to consider how to help low paid workers to access the NIC and benefit system, perhaps by extending the system of credits (as exists for those on JSA), allowing them to aggregate earnings in the event of them having more than one ‘mini’ job. Alternatively they could be provided with a way to cheaply buy in to the system, as exists in the form of Class 2 NIC for the self-employed and employed earners working abroad¹².

4.7 *Temporary work*

4.7.1 Employers often only want employees on a short term basis – if, for example, demands for their products and services fluctuate. This makes agency workers a popular choice for employers and an important part of the labour market landscape.

⁹ None of which is recoverable by employers since the abolition of the Percentage Threshold Scheme from 6 April 2014.

¹⁰ You can see our full response here: www.litrg.org.uk/zero-hour

¹¹ As of 2014/15, the LEL is £111 – with earnings at this level, employees are treated as paying NIC, even though they actually do not start to pay anything until pay exceeds the Primary Threshold of £153 per week.

¹² Per regulation 147 of the Social Security (Contributions Regulations 2001).

- 4.7.2 This type of work can offer a stepping stone into the labour market for young workers, but they are often poorly paid and frequently have to change sites to stay in work and the unavoidable costs of getting to their assignment locations to perform their duties can take up a disproportionate amount of their wages. Moreover, there is no recognition of their expenses in current tax law, despite them having little ability to plan around those costs, in contrast to the position of someone in permanent employment whose commuting costs will be more certain.
- 4.7.3 Because of this, ‘temps’ often get caught up in complex ‘umbrella’ arrangements. These provide a framework within which their successive work locations can be turned into ‘temporary workplaces’ for the purposes of meeting the requirements of tax legislation which then allows tax relief on them. There are typically some small tax and NIC savings for the worker, but cost advantages also accrue to the purveyor of the scheme, meaning that often workers are exploited for the employer’s own gain. We explained this in our written evidence to the House of Lords select committee on personal service companies last year¹³.
- 4.7.4 The exploitation may involve employers overstating the amount of the workers’ ‘tax-free’ expenses or indeed giving relief to workers that is not permitted by the rules at all. The problem here is that it is the worker (who often does not understand, or fully understand what they have entered into), rather than the employing umbrella company, that attracts the attention of HMRC’s compliance function, sometimes many years later.
- 4.7.5 Recommendation: We have, on many occasions, requested a relaxation of the outdated travel rules as they apply to low paid workers and continue to consider this as sensible and the right and proper way forward. We therefore welcome the launch of the travel and subsistence review, to which we intend to contribute. Indeed, we have recently undertaken a research exercise about umbrella companies and the low paid in which a number of interesting matters have come to light. We intend to use this to help form the basis of some of the more detailed observations and recommendations that we submit as part of that review.

Section 3 – How are different forms of remuneration used?

- 4.8 For the low paid who will often be enjoying ‘minimal’ employment relations at best, decisions about how their remuneration is provided is not necessarily the outcome of a sophisticated management decision making process or HR best practice. This means that some key aspects of their total ‘reward package’ (some of which might not even be thought of as ‘remuneration’) are often not specifically planned or considered so as to secure the best outcome for the employee.
- 4.9 For example, fault lines in the underlying tax rules around tips for those in service industries such as waiters and waitresses, or even the ability to accrue holiday pay for seasonal or casual staff, mean that small changes in the way an element is structured or in the timing of a payment can result in surprising outcomes for the unwary low paid employee. We pointed out these problematic areas in our submission to the OTS during their review of employee benefits and expenses.
- 4.10 **Tips**
- 4.10.1 Many low-paid workers survive on tips. Problems and complexity arise due to the differing tax and NIC treatment depending on whether the customer leaves a tip on the table or it is distributed by the employer, or via a ‘tronc’ system. There are several different eventualities – some of which mean the worker has to suffer NIC.

¹³ http://www.litrg.org.uk/News/2014/umbrella_schemes.htm

- 4.10.2 Recommendation: In the interests of simplicity and fairness, it is worth exploring whether there is a way of obtaining consistent tax and NIC treatment, regardless of how the tip reaches the worker. Ideally, tips would be taxable, but not subject to NIC.

4.11 **Holiday pay**

- 4.11.1 Often low-paid workers are entitled to holiday payments after they stop work. If these are received before the issuance of form P45, they are taxable in the normal way using the employee's tax code – meaning that typically a portion of their personal allowance is set against it. However, for payments after the issue of form P45, the tax and NIC treatment differs depending on whether it is a usual payment or an irregular one. For holiday pay, tax is deducted at OT code (often resulting in a flat rate 20% deduction) and NIC on a weekly earnings basis. This means that the worker often ends up with much less money in their pocket than they were expecting; they often do not understand what has happened or how to get a refund of tax, if they have overpaid.
- 4.11.2 Recommendation: Cash flow problems for the low paid and the consequences thereof (use of pay day loans, for example) are well known. We recommend that it should be explored whether, with Real Time Information (RTI) and sophisticated payroll programmes, there is a simpler way of dealing with these post-form P45 payments.

Section 4 - What does the future of remuneration look like?

- 4.12 As far as the low paid are concerned, to a large extent the future of remuneration depends on broader economic and social policymaking as well as tax policymaking. We have shown in this evidence that the working lives of the low paid (and also their dependants' lives, as we alluded to in our response to the Government's Child Poverty strategy¹⁴) are disproportionately disadvantaged by cuts to public spending, price rises and increases in insecure forms of work, in addition to tax rules that seem disconnected to their needs (not to mention badly coordinated with other related issues such as the NMW, employment law and welfare benefits).
- 4.13 In terms of bettering the tax rules, we are conscious that the OTS are making substantial effort in this area, from which we expect to see some favourable outcomes for low-paid employees in due course. Simplification, subject to mitigation of negative effects, is helpful, such as the treatment of live-in accommodation for which the current law is outdated and unnecessarily complex. One example of unfairness can occur in the case of a carer living or lodging with the person for whom they are caring, which is unlikely to be considered a 'perk' of the job, yet might give rise to benefit in kind implications¹⁵. Nevertheless, we are concerned that some problematic situations on which we have provided evidence in this response do not feature in the OTS's work programme, yet HM Treasury would do well to consider our recommendations concerning them.
- 4.14 We hope that after reviewing responses to this call for evidence, the Government's intended follow up will lead to further action to ameliorate the position of low-paid workers. We very much look forward to contributing to the ongoing work in this area and would be willing to enlarge upon any of the areas covered in this submission, if it would be helpful to do so.

LITRG
09/09/14

¹⁴ <http://www.litrg.org.uk/submissions/2014/child-poverty-strategy-2014-2017>

¹⁵ See for example LITRG's disability tax guide: <http://disabilitytaxguide.org.uk/paying-wages/what-are-wages/benefits-and-expenses/#live>