

LOW INCOMES TAX REFORM GROUP

HM Government National Minimum Wage Workers – Travel and Subsistence Expenses Schemes RESPONSE TO CONSULTATIVE DOCUMENT

1. Executive Summary

- 1.1. As our interest lies in protecting the position of the low-paid worker, we are generally in favour of preventing their exploitation and ensuring the spirit of National Minimum Wage law is complied with. However, a close inspection of the detail in this consultation document shines a light on many issues we have previously raised in response to other consultations and which need addressing in the round.
- 1.2. Our response to this consultation is, therefore, to call again for a cross-government review of travel and subsistence expenses. This should focus in detail on the issues for low-income employees.
- 1.3. Although this consultation document states that it seeks to protect the interests of workers at or near National Minimum Wage (NMW), the impact of the proposals does not seem to have been fully evaluated.
- 1.4. Whilst emphasising the potential loss of contributory benefits to workers who may sacrifice salary, the consultation document does not take account of situations in which income-based alternatives might be available or National Insurance credits effectively restore entitlement to contributory benefit. And, because of the anticipated response of employers to a change in NMW law, we fear that the forecast increase in revenue is likely to be borne to a significant degree by the low-income workers themselves.
- 1.5. Clearly there are employment businesses and umbrella companies which operate at the margins of the law, and we are not endorsing exploitation of workers. But arguably some employment businesses are of value to employees by providing overarching contract arrangements which mean that otherwise unallowable costs of travelling to temporary work placements are relievable. From our limited knowledge, there appears to be many types of employer operating in these markets, some of which appear to take the welfare of their employees very seriously. The consultation document takes extremes as examples, where we suspect that the reality is much more complex. We would welcome far more detailed information.
- 1.6. It is arguable that for those people on the lowest incomes that travel costs should be deductible from income for tax, National Insurance contributions (NIC), tax credits

and other means-tested benefits. Workers would not then be so badly disadvantaged whenever they are offered short-term work far from where they live, as often they have little choice but to accept. We acknowledge that a move to broaden tax allowances for travel expenses would be at a cost to the Exchequer, which is why we recommend a thorough cross-government review.

- 1.7. We cannot endorse the introduction of the proposed measure in a few months time without a proper evaluation of employer reaction. We would be concerned if that reaction were to trigger higher costs for employees so tipping the economic balance for them between work or reverting to benefits.
- 1.8. The objective of a comprehensive review should be to achieve simplification by aligning the rules, where practicable, across government. A further consideration should be how government can provide advice for low-income workers so they claim their entitlements and avoid making the wrong choices when offered salary sacrifice.
- 1.9. We therefore recommend that a working party of government, employer and employee representatives is urgently established to review the issues we have raised.

2. Introduction

2.1. About us

- 2.1.1. 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.
- 2.1.2. 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.

2.2. Our approach to this consultation and general comments

- 2.2.1. One of LITRG's objectives is to investigate new proposals to see what impact they may have on tax or tax credits (and, in turn, welfare benefits) and to identify any interactions that may occur. It is with this objective in mind that we have considered the consultation document '*National Minimum Wage Workers – Travel and Subsistence Expenses Schemes*'.
- 2.2.2. As our interest lies in protecting the position of the low-paid worker, we are naturally in favour of preventing their exploitation and ensuring the spirit of National Minimum Wage law is complied with.
- 2.2.3. But, we have concerns however that this consultation mixes up a range of concepts, which makes it difficult to comment coherently. A close inspection of the detail shines a light on many issues we have previously raised in response to other consultations and which need addressing in the round.

3. Our response

3.1. *Focus of the consultation*

3.1.1. We think it is a mistake to focus just on salary sacrifice within ‘travel and subsistence schemes’ as to do so alone is misleading. Salary sacrifice is merely a re-negotiation of a contract. In reality, there are several quite separate issues which the consultation document conflates. To see these more clearly, we need to compare:

1. An individual working, perhaps for an agency, at a flat hourly rate where travel and subsistence expenses are not allowable for income tax.
2. An individual working under an overarching contract – where HMRC have agreed, by implication in the consultation document, that travel and subsistence costs are allowable for income tax.
3. The same individual in 2 above who then enters into a salary sacrifice.

3.1.2. But the consultation document only compares situation 1 with situation 3.

3.1.3. There are four primary issues on which we would like to comment. These are:

- Travel expenses
- Salary sacrifice and National Insurance (NIC)
- National minimum wage legislation
- Other means-tested benefits

3.2. *Travel expenses*

3.2.1. Para 2.20 of the consultation paper points out that the current review is not seeking to change the rules surrounding travel expenses and the tax system. This may be so, but it is worth spending a little time reflecting on this issue as it is a driver in the structuring of employment arrangements. The Government also expects the proposed change to raise revenue of an estimated £35m in 2010/11 and £85m for 2011 onwards (impact assessment notes, section 6, penultimate para under ‘Revenue Effects’). It is therefore worth examining on whom this additional burden might fall.

3.2.2. The allowance for tax purposes of expenses for any travel which commences from home and ends at a place of work has always been contentious, and continues today to be the subject of tribunal cases – particularly as working patterns change with the digital age. The wording of the law can be read as almost unchanged as compared with the Income Tax Act 1853. And whilst tax credits were designed to follow tax law closely in many circumstances, it appears that expenses can be treated differently when assessing income for other means-tested benefits (see below).

3.2.3. When income tax was introduced, the working patterns of today would have been inconceivable. At that time, workers were not as mobile as they are now and it was extremely rare for an individual to need to travel in the course of their employment (indeed the allowable deduction for keeping a horse was only written out of the law in 1998). Travel expense law has even more difficulty in coping rationally with the

'flexible' labour markets of today. The concept of agencies providing labour only when an employer needs it is also a relatively modern phenomenon.

- 3.2.4. Today a worker cannot move house every few days to eliminate their travel costs. It is therefore reasonable that when a worker is required to attend at a variety of locations, the tax system should recognise that this cost, if reimbursed by his employer, should not give rise to a tax charge. Similarly if an employer does not reimburse that cost the employee should have the right, in law, to receive a deduction from his taxable earnings to reflect those unavoidable costs.
- 3.2.5. In broad terms we see little difference between an individual who has to take a number of concurrent part time or consecutive short term employments in order to earn a living wage from one where an employer has subsumed under one employment a range of activities at various locations. However our arcane travel expense tax laws do make a distinction.
- 3.2.6. Importantly, the consultation document accepts that when a series of concurrent or consecutive employments is 'packaged' in an umbrella employment, such a 'device' is effective in enabling a worker to claim the expenses for tax purposes.
- 3.2.7. From a worker's perspective it is only fair that the unavoidable costs of travel are recognised and allowed. This was a key reason for us to urge, when we responded to the July 2008 consultation¹, that the Government should carry out a wider review of tax and NIC relief for travel expenses.
- 3.2.8. One of the major influences for people deciding to remain on benefits rather than seeking to work is the impact of unrelieved travel costs. 'Better off in work' calculations often do not take these costs into account.
- 3.2.9. In our February 2010 response² to the DWP consultation '*Supporting people into work: the next stage of Housing Benefit reform*'³, we raised this point – highlighting that travel to work costs can be a major disincentive for benefits claimants moving into work. It was also raised in our joint report with Community Links and Child Poverty Action Group – '*Interact: benefits, tax credits and moving into work*'⁴, specifically illustrated by two cases – Sandra and Jim (see Appendix A, case studies 2 and 3).

3.3. **Salary sacrifice and NIC**

- 3.3.1. A salary sacrifice happens when employees give up the right to receive part of their cash pay due under their contract of employment. Usually the sacrifice is made in return for the employer's agreement to provide the employee with some form of non-cash benefit. The sacrifice is achieved by varying the employee's terms and conditions effective for employment law.
- 3.3.2. There is nothing wrong with salary sacrifice as a concept and indeed HM Treasury and HMRC have promoted it in respect of childcare vouchers. Problems can, however, arise when employees have insufficient help or information to make the

¹ See <http://www.litrg.org.uk/news/latest.cfm?id=597>

² See <http://www.litrg.org.uk/reports/submissions.cfm?id=757>

³ See <http://www.dwp.gov.uk/consultations/2009/supportingpeopleintowork.shtml>

⁴ See <http://www.litrg.org.uk/reports/reports.cfm?id=483>

most beneficial choice for them (as we have seen in the case of childcare vouchers¹).

- 3.3.3. Often when a sacrifice of cash pay is exchanged for non-cash benefits there may be some tax advantage. In other cases there may be no tax advantage, but a NIC advantage. This arises because the NIC definition of earnings has not been aligned with that for income tax.
- 3.3.4. So in the salary sacrifice situation contemplated in this consultation the tax position does not change, because it is accepted in these examples that the expenses concerned are tax allowable. But the NIC due from both the employee and the employer is reduced.
- 3.3.5. This is due to the non-alignment of tax and NIC rules rather than to any device such as an umbrella company, and would be reflected in differences between two employers, one who reimbursed an employee's expenses and one who did not.
- 3.3.6. For income tax, there is no advantage for an individual (or an employer) in sacrificing salary for expenses which are 'wholly, exclusively and necessarily in the performance' of the duties of the employment. This is because the individual is able to make a claim for such expenses under Section 337 of ITEPA (or Section 338, Travel for necessary attendance) leaving them in the same position as before the sacrifice. But, for NIC, no such claim is possible.
- 3.3.7. We believe a number of the consultation document's examples are therefore flawed in that regard, including those which extrapolate on to tax credits. For example, paragraph 2.9 states that if a worker gives up pay of £95 and in return receives expenses of £72, there is an increase of £6.45 in the worker's take home pay. This is incorrect as it is not comparing like with like.
- 3.3.8. In making that comparison, the consultation document is looking at the position of an employee not in an overarching contract (and therefore not being able to claim travel costs) against an employee who is **both** working under an overarching contract **and** has chosen to sacrifice. This misses out a vital step and what it should compare is the employee who has an overarching contract who **then** chooses to sacrifice salary.
- 3.3.9. Following this logic, it is implicit in Example D that the individual concerned in this example incurs allowable travel expenses of £72 per week. If this were not so HMRC would be assessing the individual upon the reimbursed travel expenses in the second leg of the example. Therefore, the individual is incurring these expenses wholly, exclusively and necessarily in the performance of his duties. He will still be incurring these expenses in the first leg of the example. As such he will be able, at the end of the tax year, to make a claim under Section 337 or 338 ITEPA 2003 for the travel expenses to temporary workplaces in order to reduce his weekly tax liability by £14.40 per week. So when the consultation document says he is better off in cash terms by £6.45 per week he is, in fact, £7.95 worse off as compared to a worker under an overarching contract who does not sacrifice.
- 3.3.10. An individual, properly advised by HMRC, would not enter into such a sacrifice.

¹ See our article 'Childcare vouchers – still a trap for many' - <http://www.litrg.org.uk/news/index.cfm?id=777>

3.4. ***National minimum wage legislation***

- 3.4.1. The concept of a living wage embodied in the national minimum wage must logically be a gross wage which provides a certain minimum level of benefit to the individual (but before tax and National Insurance). Different occupations have different expenses to be incurred in their performance. Whether an individual reasonably incurs expenses of £10 a year or £5,000 a year should be irrelevant as a reasonable employer would always reimburse such costs whatever the level.
- 3.4.2. So if there is a definition for NMW purposes which does not meet those criteria, it should be changed. But any change should seek to align the language with tax and other law rather than trying to create new definitions. That way would lead to simplification rather than continued complexity.

3.5. ***Other means-tested benefits***

- 3.5.1. Working Tax Credit (WTC) is referred to in the consultation document. Although we believe that the logic of the examples is flawed, it is interesting to see how WTC provides a 39% subsidy to individuals who are, in reality, paid below the NMW. When coupled with the very low thresholds for both tax and National Insurance, this makes planning inevitable. For every £ increase in assessable income the worker faces an effective marginal 'tax' rate of 70% when adding together 20% basic rate tax, 11% NIC (at the current rate) and 39% tax credits withdrawal. The Exchequer is therefore contributing to the problem.
- 3.5.2. If the rules were to change in October 2010 along the lines proposed in the consultation document, HMRC would need to give adequate information and advice to those affected as tax credit overpayments could occur. Many of those affected might not see an impact on their 2010/11 awards because of the £25,000 disregard, but an overpayment could arise in 2011/12 if they do not provide an update of estimated 2010/11 income to HMRC. Also, if someone is on a current year basis in 2010/11, any increase in assessable income will immediately cause an overpayment.
- 3.5.3. All the various arrangements contemplated should also take into account the knock-on effects for other means-tested tested benefits, such as housing benefit (HB) and council tax benefit (CTB), which are not covered at all in the consultation document. These are benefits which can be very important for the kind of workers who are being considered in the consultation.
- 3.5.4. For example, regulation 35 of The Housing Benefit Regulations 2006 [SI 2006/213] deals with the assessment of earnings for HB purposes. The rules are the same for CTB. These rules state that reimbursement of home to place of employment costs may be treated as earnings for assessment of entitlement to those benefits. Whether they are so included does not necessarily follow the income tax treatment. In a 2008 judgement, social security commissioner Edward Jacobs said:

'Finally, Mr Cullimore [for the Local Authority] argued that the housing benefit and council tax benefit law could have been worded in the same way as that for income tax if the same result was intended. I do not believe that the chairman was saying that the law was the same for both income tax and benefit law.'¹

¹ See CH/1330/2008, 21 October 2008
http://www.bailii.org/uk/cases/UKSSCSC/2008/CH_1330_2008.html

- 3.5.5. In the above case, the appellant succeeded in arguing that employer contributions to travel expenses were both relievable for tax and excluded from earnings for the purposes of HB/CTB assessment. However, the means of arriving at this conclusion was not the same for tax and benefits, and indeed the commissioner's comments make it clear that a different result could be arrived at. This reinforces our argument that a holistic view must be taken.
- 3.5.6. The consultation document emphasises the potential loss of contributory benefits to workers who may sacrifice salary. Yet it does not take account of situations in which income-based alternatives might be available or National Insurance credits (such as those given to people in receipt of WTC disability element) effectively restore entitlement to contributory benefit.

4. Consequences of change

- 4.1.1. The underlying premise from many of the examples used in this consultation document is that either:
- the travel expenses actually incurred by employees are, in reality, far less than are sacrificed in salary; and/or
 - no-one has ever told employees that for both income tax and tax credits purposes, travel expenses incurred by an individual in the proper performance of their duties (or in attending a temporary workplace within the definition in S339 ITEPA 2003) may be deducted from their income before calculating the appropriate income tax liability, or disregarded when assessing their tax credit award.
- 4.1.2. If either of those conclusions is correct it is within HMRC's own hands to do a lot more by way of education or compliance activity to address a number of the concerns.
- 4.1.3. In order to debate whether an employee will or will not be better off after the proposed change to the NMW rules it is necessary to analyse the likely reaction of employers. If their business model is dependent upon supplying the labour of their employees at a small mark-up on the costs of employing those workers, then any change will have knock-on effects.
- 4.1.4. One very probable scenario will be that employers will revert to standard agency arrangements and remove overarching contracts, then pay the individual the NMW in cash and let the individual bear all the expenses of travel. This will enrich the Exchequer because more NIC is paid by the employer and the employee but the worker will be worse off, not only in NIC terms but also being unable to claim tax relief, seeing a reduction in tax credits and losing wider employment rights. So the effect will be to gather more revenue from some of the lowest earning workers, some of whom might then conclude that reverting to state benefits would give them a better standard of living.

5. Conclusion

- 5.1.1. It is stated in the consultation document that the Government's objectives are threefold:

1. To ensure the contributory benefit position of workers is not prejudiced.
2. To ensure that no unfair competitive advantage is gained through the use of travel and subsistence schemes.
3. To protect the Exchequer.

5.1.2. Our response shows that objective 1 may be over-stated; that the analysis in 2 is flawed; and in terms of 3 that a change in the law will increase the revenues of the Exchequer, but with the possibility of it being primarily at the expense of low-paid workers.

5.1.3. We think it is unwise to introduce change in this piecemeal fashion. Clearly there is exploitation of workers by some; but equally clearly there is a rag bag of badly co-ordinated legislation across government departments. It is also plain that unless the consequences of these actions are fully evaluated, low-income workers may bear the brunt of the changes.

5.1.4. While we endorse the Government's wish to end exploitation of low-paid workers, we cannot endorse the introduction of this particular measure without a more comprehensive and wide-ranging review. We therefore recommend that a working party of government, employer and employee representatives is urgently established to review the issues we have raised.

LITRG
6 May 2010