

**Employee Benefits and Expenses – exemption for paid or reimbursed expenses
HM Revenue & Customs (HMRC) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We welcome the opportunity to respond to the HMRC consultation document on an exemption for paid or reimbursed expenses. We note that it contains the proposal to replace the expenses dispensation regime with an exemption for expenses paid or reimbursed by employers.
- 1.2 We commend the Government and HMRC for providing sufficient time to formulate responses, for holding meetings with interested parties to discuss the consultation, for consulting simultaneously on four connected measures and also for issuing a call for evidence on remuneration practices. We note that the Government has also launched a review of the rules on travel and subsistence.
- 1.3 We agree that if this exemption is introduced it should apply to all employers who make expenses payments. This should be a single regime, which applies to all employers: large; small; and one person companies. This will provide the most simplification, and will also assist both HMRC and employees in terms of only having to deal with one system.
- 1.4 It is important that the new statutory exemption provides certainty for employers. Currently, HMRC should only issue a dispensation where they are satisfied that the benefits provided give rise to no tax liability and that the employer has satisfactory controls in place.¹ This

¹ s. 65 ITEPA 2003.

means that an employer who has made a correct application has some comfort in relation to their tax and National Insurance treatment of relevant benefits and expenses.

- 1.5 We think that the provision of non-prescriptive ‘models’ of acceptable record keeping will assist employers. In addition, we think that there needs to be a dedicated channel for employers to contact HMRC and obtain assurance that they are applying the exemption correctly. This will be especially relevant when the exemption is first introduced and also for employers whose circumstances are not covered by the models.
- 1.6 This proposal does nothing to help those employees to whom employers do not reimburse expenses but nevertheless incur qualifying costs, for example care workers’ travel costs between jobs. We will comment in more detail on this issue in our submissions to the travel and subsistence review.²
- 1.7 We recommend that discrepancies between expenses rules for relief and reimbursements are ironed out, and also that unreimbursed employees should be allowed to reclaim Class 1 primary National Insurance contributions in addition to being able to claim tax relief on deductible expenses. This would make the regime easier for employees to understand, and simpler for employers to explain to employees. In light of the current mismatch however, we also recommend that the employer make the employee aware of the rules that allow them to claim tax relief from HMRC for certain expenses if they do not provide reimbursement.
- 1.8 We think the Government and HMRC need to clarify once and for all their position on umbrella companies who are operating so-called ‘pay day by pay day’ schemes. These umbrella companies apply tax and National Insurance relief at source through their payrolls to expenses which are incurred by employees but not reimbursed by the employer. We understand that HMRC do not agree this practice is legitimate according to their interpretation of the law, yet the schemes continue to operate which is worrying.
- 1.9 It is important that discussion takes place with other parts of HMRC, namely Benefits and Credits, as well as the Department for Work and Pensions to ensure that any potential effects of these changes on tax credits and means-tested benefits are fully considered. This may mean changes to legislation to align the rules and make sure that no-one is disadvantaged, but it may also mean ensuring that guidance and instructions to claimants are clear and match with the new tax practice particularly where claimants are required to provide information. It is important for claimants to know whether or not to deduct the expenses for tax credits and means-tested benefits purposes and there should be no confusion on these aspects.

² HMT launched a travel and subsistence review on 31 July:
<https://www.gov.uk/government/consultations/travel-and-subsistence-review>

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 note that the subject of this consultation document comes directly from the recommendation at para. 3.1 of the Office of Tax Simplification's (OTS) report published in January 2014.³ The objective behind the recommendation was to create a more practical approach to the treatment of qualifying business expenses paid for or reimbursed by an employer and to remove the need for employers to obtain P11D dispensations.
- 3.2 Para. 3.4 of the consultation document states that the Government believes this proposed change would reduce the administrative burdens of employers. We agree that it would relieve burdens in relation to P11D dispensations and forms P11D.
- 3.3 We note however that many employers pass over the task of completing forms P11D to an agent: some employers do not engage with the tax rules to determine whether or not they are providing the correct information. They rely on the agent selecting the correct information from surplus data, or asking for particular items of information. If this proposal is pursued, employers will need to engage with the tax rules, for example to determine which types of expense fall within the exemption and take the time to apply them. So although overall this proposed change is expected to make the process of dealing with reimbursed expenses simpler, for some employers it will result in an increased administrative burden. This demonstrates why the provision of guidance by HMRC is

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OT employee_benefits_final_report.pdf

essential and also the communication of the changes and their implications for employers. It also means there needs to be sufficient lead-in time to allow employers to familiarise themselves with the rules and to make plans to cope with a potential increase in administrative tasks.

- 3.4 We are concerned that there has been a constant creep of risk away from HMRC and on to employers. Initially, when an employer applied for a dispensation, they needed to write in detail and provide evidence such as contracts and policies. It is only recently that HMRC introduced the form P11DX, creating a standardised template. This presumably made it easier to process for HMRC, but the risk and responsibility that the dispensation was valid, for example that the reimbursed expenses were incurred wholly, exclusively and necessarily for business purposes were shifted entirely onto the employer. It appears that this proposal takes this a step further, by placing the onus on the employer to research the rules and take decisions based on their view of the law. This places HMRC in a very passive role. We recommend a light touch on penalties and interest, especially for any employers who have been inadvertently non-compliant.
- 3.5 We note that the proposal is for the exemption to apply to all employers who make expenses payments.⁴ We agree that this should be the case. This will make it simpler for employees to understand, particularly if they have more than one employer from which they receive reimbursed expenses. It should make it simpler and therefore more efficient for HMRC. It should also make it simpler for employers, as there will be no complication of choosing between systems. Employers may report problems or be uncertain about certain aspects of the exemption, particularly when it first comes into force. HMRC can offset these issues to a large extent if they commit resources to solving problems, providing clear guidance and updating the guidance regularly.
- 3.6 There will however be employers who do not reimburse or cease to reimburse deductible expenses.⁵ For employees who incur deductible expenses, it is important that there is a clear and simple process for claiming tax relief, that this process is well-publicised and communicated so that they are aware of it, and that there is clear guidance so that they can make accurate claims.

4 Q1 If the Government were to provide ‘models’ of acceptable record keeping and checking processes would this be helpful for employers? Where the models are not appropriate for employers, would those employers feel disadvantaged, even if it is made clear that they are not exhaustive?

⁴ Para. 3.8 ff.:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321201/expenses_exemption_180614.pdf

⁵ See our comments at sections 4 and 5 below on the possible effects of poor guidance and not allowing salary sacrifice in conjunction with the exemption.

- 4.1 We think that it would be helpful for employers if ‘models’ of acceptable record keeping and checking processes were provided. Models and guidance need to show employers what evidence is acceptable to prove that they have taken care and acted reasonably when applying the exemption.
- 4.2 We understand that it is HMRC’s intention that the record keeping requirements for employers will remain the same for the exemption as they are for dispensations currently. It would be helpful if the guidance was clear for employers about the form of records and use of electronic records in particular.
- 4.3 There is a need for clarity for employers with regards to their checking and record keeping requirements. Presumably HMRC would have to follow up with some sort of compliance check to ensure that employers are keeping adequate and appropriate records and making the necessary checks. We are in agreement with the OTS, who recommended in their report that minimum requirements should be set out in primary legislation or regulations.⁶ This would ensure some clarity and certainty for employers, and then employers could maintain more detailed records if they wish.
- 4.4 We think that the suggested details set out at para. 4.6 of the consultation document would form a strong basis for a ‘model’ of acceptable record keeping and checking processes. These types of detail would be helpful to employers, and help provide them with assurance that they are complying with the requirements of the exemption.
- 4.5 In providing the models, it would be important to highlight the fact that they are not comprehensive or prescriptive and that different steps may be appropriate depending on the particular circumstances of the employer. One option might be to provide a helpline or channel for the employer to contact if they do not feel that they can follow any of the suggested models, to allow them to discuss what might be acceptable for their business. If this is highlighted in the guidance, we do not think that the provision of such models would make employers feel disadvantaged. It would also provide assurance if the guidance were to emphasise that the key point is that the employer should be able to provide evidence of a process for checking expenses and also provide records that support the fact that they have reimbursed allowable expenses only.
- 4.6 We think that if the models for acceptable record keeping and checking processes are not intended to be prescriptive, and are rather intended as a starting point for employers to devise their own processes, they should be contained in guidance, not secondary legislation. We note and agree with the points made in para. 4.8 ff. of the consultation document concerning this issue. Inclusion in secondary legislation could make the models appear

⁶ Para. 3.3:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OT employee benefits final report.pdf

prescriptive and might worry employers if they feel unable to follow one of the models perfectly.

- 4.7 It is important that the models and guidance are reviewed regularly and kept up to date. If common issues recur, HMRC should incorporate these into the guidance.
- 4.8 If the models and guidance are not clear, and if it is not possible for employers to check easily with HMRC whether or not the exemption applies, we are concerned that some employers, particularly those with fewer resources at their disposal, may cease to reimburse employee expenses. This would mean the employee has to claim tax relief direct from HMRC. The employee would lose out financially by comparison to full reimbursement, and also would only receive relief in respect of income tax, not National Insurance contributions.

5 Q2 Are you aware of any types of arrangement that seek to replace taxable pay with payments of non-taxable expenses which the Government should focus on in particular when tackling this issue? Are you aware of any types of these arrangements where tackling them might disturb business practices that are not tax or NICs motivated?

- 5.1 We have come across these types of arrangement and have described them previously in the course of our response to the 2012 HMRC consultation “Lifting the lid on Tax Avoidance Schemes”.⁷ We discussed these arrangements in section 5 of that response, and noted that they were often used in connection with schemes that force individuals to work through umbrella companies. These often affect low income workers, with a variety of occupations, for example, cleaners, nurses, factory workers and drivers.⁸ As these schemes usually mean reduced payments of National Insurance contributions, the main benefit accrues to the ‘employer’. Although the ‘employee’ pays fewer contributions also, this benefit is tempered by the fact that it may result in a reduction in their entitlement to contributory benefits, as pointed out in para. 4.14 of the consultation document, a reduction that often will not have been brought to their attention. As we noted in our response to the 2012 consultation, sometimes these arrangements mean that the employee receives less than the National Minimum Wage; in addition, sometimes the expenses have not actually been incurred – the employer simply uses a round number with varying degrees of justification.
- 5.2 We support the Government in its efforts to tackle abusive arrangements. In terms of the approach to adopt in order to deter and prevent abuse of an exemption, we think that although not allowing salary sacrifice arrangements in connection with the exemption for

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http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PRO_D1_032207

⁸ Section 5, in particular, para. 5.11 ff.:

http://litrgold.cubik.co.uk/Resources/LITRG/Documents/2012/10/121015_LITRG%20Response_Lifting%20the%20Lid%20on%20Tax%20Avoidance_final.pdf

reimbursed expenses could help to deal with abusive arrangements, it would also catch non-abusive arrangements.

- 5.3 We recommend that the issue of these types of abusive arrangements should be considered in more detail separately. Some, at least, of the abusive arrangements cause employees to receive wages that fall below the National Minimum Wage, as noted above (para. 5.1). We wonder whether it might be possible to tackle those arrangements and employers through National Minimum Wage legislation.
- 5.4 We think the Government and HMRC need to clarify once and for all their position on umbrella companies who are operating so-called ‘pay day by pay day’ schemes. These umbrella companies apply tax and National Insurance relief at source through their payrolls to expenses which are incurred by employees but not reimbursed by the employer. We understand that HMRC do not agree this practice is legitimate according to their interpretation of the law, yet the schemes continue to operate to this day.⁹
- 5.5 Since the proposed exemption would in general apply to allowable business expenses, we do not see that there is normally any reasonable justification for an employer to demand that an employee sacrifices part of their salary if they wish to receive reimbursement for allowable business expenses. However, there may be cases where an employer has historically paid employees a round sum travel allowance. If they give the employee the option of giving up the travel allowance and instead receiving reimbursement for actual deductible travel and subsistence expenses incurred, this would not seem to abuse the rules.
- 5.6 We also take this opportunity to remind HMRC that some lower paid workers do not receive reimbursement for allowable business expenses (and the National Minimum Wage rules allow this). For example, some care workers do not receive mileage reimbursements for travel between clients. It must be remembered that some workers accept such conditions, because they simply have to take what work they can get. In addition, often the matter is ‘explained away’ in inductions by employers – the worker can claim the 45p per mile amount from HMRC (the employer does not explain that this will only be the tax relief on the 45p, not the actual 45p). In addition, some of these workers will not have income exceeding the personal allowance, and therefore they cannot claim tax relief from HMRC because they do not have a tax liability in the first place.
- 5.7 It has also been suggested that some employers would stop reimbursing allowable expenses completely, if they cannot utilise salary sacrifice with the exemption. The result will be that some employees will lose out completely, either because they do not pay enough tax to get full tax relief, or because they do not realise they can claim tax relief.

⁹ HMT/HMRC held a consultation in 2008 – “Tax relief for travel expenses: temporary workers and overarching contracts” (July 2008). HMRC issued Revenue & Customs Brief 50/09 in August 2009, but compliance activity does not appear to be significant: <http://www.hmrc.gov.uk/briefs/income-tax/brief5009.htm>

5.8 Currently it is possible for employees to submit form P87 to claim tax relief in respect of deductible expenses. We recommend that HMRC develop a simpler process for tax relief claims in respect of allowable expenses. Good communication and guidance for employees will be essential. This proposal may lead to HMRC receiving more claims for tax relief from employees; since HMRC's first check when receiving a form P87 is to see if the employer has a dispensation in place, they will need to devise a new means of ensuring that claims are valid and accurate, otherwise this could become a drain on HMRC resources.

5.9 Ideally the expenses rules for relief claimed should match those for reimbursements. This would make the regime easier for employees to understand, and simpler for employers to explain to employees. The current system contains many mismatches, which are unfair and weight the scales in favour of the reimbursed employee rather than the unreimbursed. For example, there is a five pence a mile passenger rate for reimbursements, but not for tax relief claims.¹⁰ In addition, an employee whose deductible expenses are not reimbursed loses out because inevitably, tax relief at 20% is not as generous as full reimbursement, but also because there is no ability to reclaim Class 1 National Insurance contributions. We recommend that not only should discrepancies between expenses rules for relief and reimbursements be ironed out, but also unreimbursed employees should be allowed to reclaim Class 1 primary National Insurance contributions in addition to being able to claim tax relief on deductible expenses. In light of the current mismatch however, we recommend that the employer make the employee aware of the rules that allow them to claim tax relief from HMRC for certain expenses if they do not provide reimbursement.

6 Q3 In what circumstances would an employer currently apply for a custom scale rate? Other than the expenses covered by the benchmark scale rates, which expenses do employers commonly request a scale rate for?

6.1 This question is for employers to answer and we do not comment.

7 Q4 Are there any examples of particular industries or types of employer who would be affected if custom scale rates could not be used with the proposed exemption? What would the impact be on those employers?

7.1 This question is for employers to answer and we do not comment.

¹⁰ Another example concerns employees who 'volunteer' to work at home on a regular basis, but do not have to do so. They can receive contributions (free of tax and National Insurance) of up to £4 per week or £18 per month from their employer, or more if the employee can prove the costs have been higher than this. If the employer does not contribute though, the employee cannot claim any relief for their expenses of working at home.

8 Q5 Would employers be disadvantaged if a process to apply for custom scale rates were not retained? If such a process were retained, would it be seen as additional complexity by those employers who do not need it?

8.1 This question is for employers to answer and we do not comment.

9 Q6 Would employers welcome the ability to self-certify the sampling exercise undertaken to support a custom scale rate? If so, would a sampling process set out in guidance or regulations provide sufficient certainty for employers that wish to use a custom scale rate?

9.1 The first question is for employers to answer and we do not comment.

9.2 In relation to the second question, we reiterate the points made previously in this response concerning 'models' for record keeping and checking processes (section 4 above). If the sampling process is intended to be viewed as an example, then we think it should be contained in guidance. Inclusion of the sampling process in regulations would suggest that it is prescriptive.

10 Q7 What are the reasons for one person companies and very small, close companies paying scale rates to directors in respect of expenses? Would such employers be disadvantaged if they were not permitted to pay scale rates to their directors under the proposed exemption? If so in what way?

10.1 This question is for employers to answer and we do not comment.

11 Q8 Would employers welcome being able to continue to rely on their existing dispensation for a transitional period, or would this be a source of unnecessary complexity? If so, how long would the transitional period need to be to be useful?

11.1 Overall these are questions for employers. However, we are not convinced that a transitional period during which employers may continue to rely on an existing dispensation would be workable or fair. As noted in the consultation document, this could be a source of complexity for employers and HMRC. In addition, some employers do not currently have dispensations, even though they reimburse expenses, and one could argue that a transitional period of this nature discriminates against those employers.

11.2 The key to providing assurance for employers who take comfort from their dispensation, and indeed for all employers, will be the provision of clear and easy to follow guidance, and ensuring that it is communicated effectively to all employers. In particular, HMRC must clarify any changes and what they mean for employers.

12 Q9 Independently of whether existing dispensations may continue to be used, would employers welcome being able to continue to use any custom scale rates they had agreed as part of their dispensation for a transitional period? If so, how long would the transitional period need to be to be useful?

12.1 Overall these are questions for employers. We note the practical difficulties that would be likely to arise if there is no transition period in respect of custom scale rates – not least the administrative burdens for both employers and HMRC that would result – and therefore think that it would probably be sensible to have a transitional period for custom scale rates.

13 Q10 Are there any specific situations or circumstances in which employers would not feel confident paying expenses because of a lack of clarity in HMRC’s guidance? Which changes could HMRC make to its guidance that would have the biggest impact on employers’ confidence in paying these expenses?

13.1 Clearer HMRC guidance on the income tax and National Insurance contributions treatment of expenses for both employers and employees is essential. In particular, we think that the guidance needs to be kept up to date – we agree with the OTS that the guidance should be ‘active’ or ‘dynamic’.¹¹ We would expect HMRC to develop the guidance through experience of different issues and queries that are raised. We would welcome a commitment from HMRC that they will ensure the guidance is clear and regularly updated.

13.2 Employers may lack comfort and certainty in respect of out of the norm expenses that do not fall within the examples provided in guidance. This provides a further argument in favour of HMRC ensuring their guidance is active, as noted in para. 13.1 above. It would also help if HMRC are willing to devote sufficient manpower to provide employers with the chance to have dialogue with HMRC about issues that arise.

13.3 Employers will however have the task of reading and understanding the guidance, and face the risk of relying on their interpretation of that guidance. We recommend that HMRC ensure the Employer’s Helpline, or other new helpline dedicated to benefits and expenses, is properly resourced – both in terms of coping with the volume of queries and in respect of dealing with the technical issues that arise.

13.4 It is important that employers are well-equipped to answer queries from employees and that HMRC provide clear guidance for employees too. One reason for this is to ensure that employees can deal with their allowable business expenses correctly. For example, it will not be advantageous for HMRC (or the employee in the long-term), if an employee claims tax relief for allowable expenses that have been reimbursed by their employer. According to

¹¹ Para. 3.7:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/275795/PU1616_OT employee_benefits_final_report.pdf

para. 3.12 of the OTS report, HMRC check whether or not the employer has a dispensation when dealing with a form P87 claim. If the proposed exemption is introduced, there will be no means of HMRC checking quickly whether or not the employer has reimbursed the expenses in question. Clear guidance for employees will hopefully minimise the number of incorrect claims and reduce the administrative burden for HMRC of checking these claims.

14 Q11 Would employers and other affected parties welcome the exemption not coming into force for a period of time after the legislation is in place? If so, how long would employers and other affected groups need to prepare for the new exemption coming into force?

14.1 We think that it is important that the implementation of this exemption is not rushed. Sufficient time must be allowed for employers (large and small), software providers and HMRC to prepare their systems for the exemption. In addition, providing legislation first and then implementing at a later date will give HMRC the opportunity to provide clear, active guidance, that is available before the start of the regime. It will also give employers time to become familiar with the new exemption. A delay in implementation would probably mean that there would be no need for a transitional period for dispensations, allowing for a more straightforward implementation process. We agree that the most straightforward option is to introduce the legislation, and then at a later date for the exemption to take effect.

14.2 The exemption must take effect from the start of a new tax year, in order to avoid unnecessary complications. We are not in a position to state how long employers, software providers and HMRC will need to prepare for the introduction of the exemption. However, we do not think the exemption should come into force before 6 April 2016. On this basis we would expect the legislation to be passed as part of Finance Act 2015.

15 Q12 How should dispensation applications that are made in the intervening period be handled?

15.1 We think that it should be possible to make P11D dispensation applications as normal in the intervening period. HMRC would have to make it clear to the applicants, however, that a new regime is being introduced and that these would cease to have effect from the date of the introduction of the new statutory exemption. This could be by including a message to the employer that the rules will be changing, when they will change and how they can find out more information. We agree that it is important that there should be no incentives to apply for a dispensation in the intervening period,¹² other than the current incentive of reduced administration. We refer to our response to question 8 at section 11 above.

¹² Para. 6.22:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/321201/expenses_exemption_180614.pdf

LITRG
8 September 2014