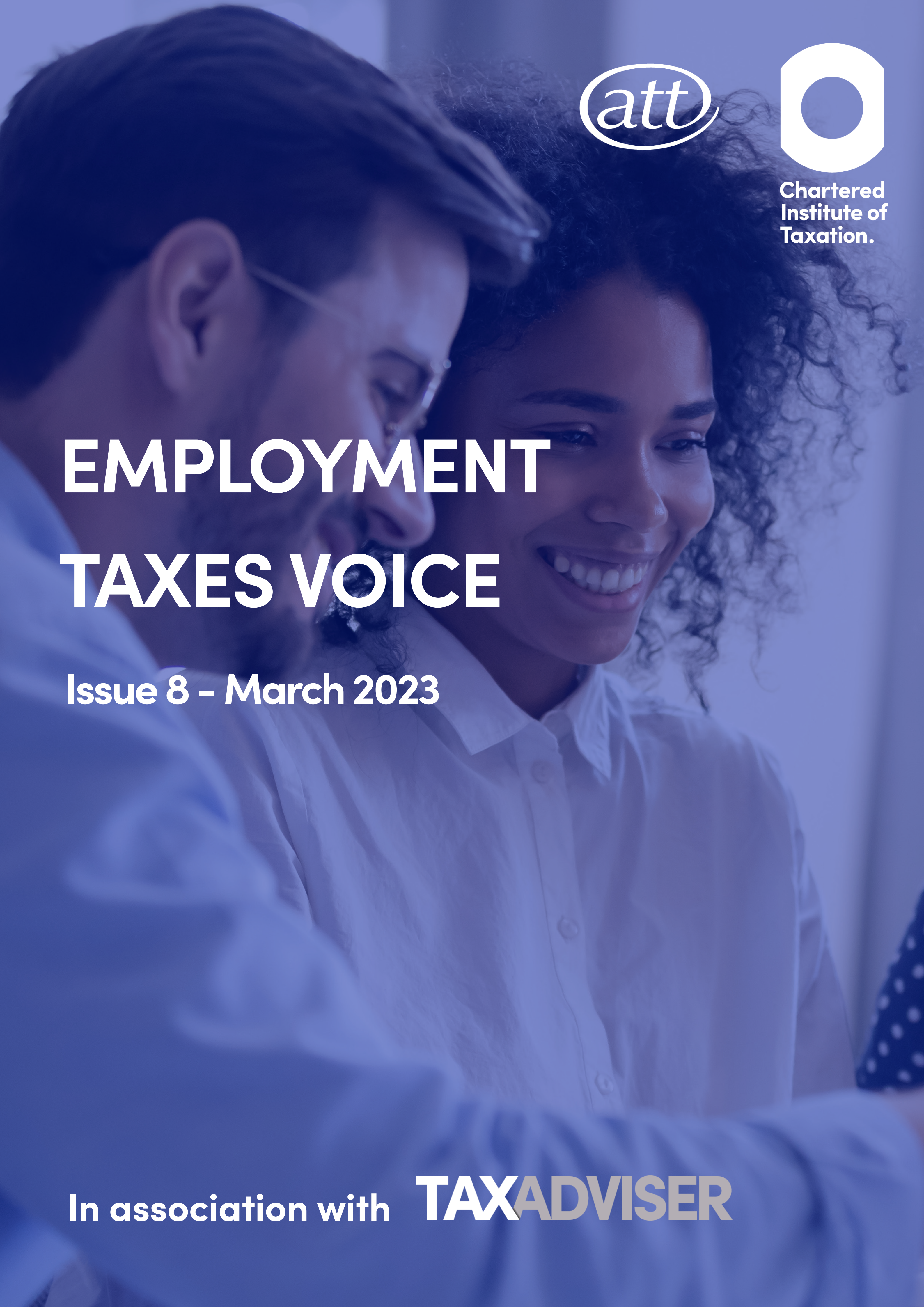

Chartered Institute of Taxation.

EMPLOYMENT TAXES VOICE

Issue 8 - March 2023

In association with TAXADVISER

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Employment Taxes Voice

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*All articles were written prior to the Budget on 15 March 2023.

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Welcome from the Chair

The time flies by quickly and it's a year already since our last edition of Employment Taxes Voice. So welcome to this edition and to another collection of articles which reflect on some of the key issues which we all deal with as practitioners on a daily basis.

We have articles on tax treaty residence, tax reliefs for homeworking, electric cars, managed service companies, the agency rules, pension contributions: net pay v relief at source, salary sacrifice and the CIOT's recent Employment Taxes submission ahead of the Budget on 15 March. So hopefully something for everyone!

But I also want to say a few words about the work the CIOT's Employment Taxes Committee does throughout the year in terms of our participation in various HMRC Forums, responding to consultations and our proactive submissions to HMRC/HM Treasury. All of these being aimed at improving life for employers, employees, practitioners and HMRC alike.

Our work with HMRC Forums includes participation in the Employment & Payroll Group (the main forum dealing with employer/employee tax and payroll matters), the Share Schemes Forum, the Pension Industry Stakeholder Forum, the Construction Forum, the Joint Forum on Expatriate Tax and NIC, the Employment Status & Intermediaries (ES&I) Forum and the Collection of Student Loans sub-Group. Our participation in these Forums enables us to raise technical and administrative points with HMRC on an ongoing basis and to try to find practical solutions as to how they can best be addressed.

As regards responding to consultations and our proactive submissions, I would highlight three matters in particular.

Firstly, our response to the Call for Evidence on hybrid and distance working issued by the Office of Tax Simplification (OTS) in August last year. This was the last piece of work undertaken by the OTS prior to its closure (which I personally think is a great shame). It covered both domestic and international issues and it raised a number of important questions, particularly in light of the much greater prevalence of offsite working as a result of the pandemic. Our submission (https://www.tax.org.uk/ref1010) highlighted some of the challenges around getting tax, social security and payroll issues right for those spending periods working outside the UK, the converse for those working here, tax residency implications, as well as domestic UK issues such as the deductibility (or not) of home to work travel, household expenses, office equipment and the knock-on impacts of locality-based exemptions such as for annual functions and cycle-to-work schemes. This followed detailed discussion with the OTS on these points. This said, whilst the OTS published a summary of its findings last December it remains to be seen what action the government will take in response, and when. Eleanor Meredith has more to say on existing tax reliefs for homeworking (and their limitations!) on pages 8 to 10.

Secondly, our Budget submission on Employment Taxes ahead of the Spring Budget on 15 March. This included a total of 34 recommendations relating to the cost of living (8), employment tax simplification (22) and pension tax matters (4). In particular, we recommended amongst other things that that the value of a number of thresholds/allowances be increased in light of inflation, that consideration be given to codifying the meaning of employment for tax purposes, that exemptions covering employer provision of certain benefits (e.g. flu vaccinations be extended to include employer reimbursement and that an exemption should apply for employer-sponsored money coaching advice for employees (i.e. extending the exemption at Section 308C, ITEPA 2003 which deals with pension arrangements). We hope the Chancellor takes note of our suggestions and we will find out very shortly! Matthew Brown has more to say about our Budget submission on pages 50 to 51.

Thirdly, a proactive submission that we made some time back to the ES&I Forum that relates to the IR35/OPW rules and how they should operate where things have not gone as they should and the client has completed a Status Determination Statement (SDS) indicating "outside IR35/OPW", i.e. no PAYE/NIC need be accounted for on payments to (say) a Personal Service Company, when in fact the SDS should have indicated "inside IR35/OPW". At the moment settlement of the PAYE/NIC by the client would be without any set-off for tax paid by the PSC (and the worker, e.g. for tax paid on dividends). Whilst we don't know what action, if any, the government will decide to take, we do hope that something will be done, both to alleviate the position for clients and to ensure that tax is not collected twice over (i.e. by both the PSC/worker and the client under the settlement). Set-off is, of course, already provided for in mis-categorisation cases involving direct engagement between clients and workers, further to Regulations 72E-F of the 2003 PAYE regulations (and following *Demibourne Ltd* v *HMRC* [2005] SpC 00486). It seems to us only fair that it should apply to OPW cases as well.

I should like to thank all the authors who have contributed articles for this edition of Employment Taxes Voice. Your efforts are very much appreciated! And also to say that we are always looking for volunteers who would like to be involved with the work we do on the Employment Taxes Committee – if you are interested please do let me know.

Colin Ben-Nathan

Tax residence of individuals and the Centre of Vital Interests

Eleanor Meredith considers tax residence and the application of treaty tie-breakers tests

Introduction

Changing work patterns since the pandemic have made it ever more challenging to determine individuals' tax residence, both domestically and, where they divide their working time across two or more countries, under any relevant double tax treaty. In particular, where an employer has assigned an individual to a country, but that individual returned 'home' during the pandemic and undertook many of the assignment duties remotely, treaty residence may be unclear, especially where the contracting states took different views of the impact of the disruption caused by the pandemic.

This brief article considers the main treaty tie-breaker tests, how they typically apply and why this might matter from an employer's perspective.

Dual residence

Although it is technically possible not to be tax resident anywhere, it is far more common to be resident in at least one country, and in some cross-border situations, in more than one. Most countries have their own rules for determining tax residence under domestic law, and treaties typically start from the position that any individual who is tax resident under domestic law, may potentially be resident under the treaty. Where this leads the individual to be resident in both countries (dual resident), most treaties then go on to apply a series of tie-breaker tests, in order to decide where the individual is resident for the purposes of the double tax treaty.

In the OECD Model, and many of the UK's treaties, the tie-breaker tests are as follows:

- **Permanent home** - If the individual only has a permanent home in one country, he/she will tie-break there, or if he/she has a permanent home in both he/she will tie-break to wherever his personal and economic relations are closer (centre of vital interests or "COVI");
- **Habitual abode** – if COVI cannot be determined or if the individual does not have a permanent home in either country, he/she will be resident where he has a habitual abode;
- **Nationality** – if he/she does not have a habitual abode in either territory, he/she will be treaty resident in the country of which he/she is a national; or
- **Competent Authority** – if none of the above apply, it is up to the Competent Authorities of the countries concerned to come to a mutual agreement about where the individual is treaty resident.

The first three tests above will usually determine the matter between the treaty countries, although not invariably, and they have been particularly uncertain in the context of changing working patterns following the pandemic, as explained in the next section.

The tests in more detail

At a treaty level, meanings of words and phrases will not generally read across from domestic law, and some further commentary is likely to be helpful.

A home has to be permanently available to count for the tie-breaker, but it need not be owned, or be of a set type or standard. An assignee who lets out the house he/she owns in his/her home country, but occupies a rented flat while on assignment, is likely to have a permanent home only in the host location, because only the flat is permanently available. It is also worth noting that the OECD model and most tax authorities attach some weight to a permanent home in the home country being retained (ie not being sold or let out) and regard this as a potential indicator of COVI having remained in that country.

The other factor which is given a lot of weight in the context of COVI is where the spouse and any minor children may be. While it is perfectly possible for a UK national working full time outside the UK to cease to be UK resident domestically, if the family remain in the UK, in the permanent home, and the requirements for full time working abroad are not met, the individual will be at risk of remaining UK resident under both the Statutory Residence Test and any treaty applying.

Where the individual has no permanent home or the COVI test is inconclusive, the habitual abode test has to be considered. This will usually look at where the individual has lived most of the time over an extended period, covering some years (HMRC usually consider a four-year period). In the context of international assignments, it is quite common for habitual abode to remain in the home country, especially for shorter-term assignments and towards the beginning of longer-term assignments, because of the 'look-back' nature of the test.

How did this all work during the pandemic?

The OECD released two separate sets of guidance regarding the impact of COVID-19, both of which were open to considerable interpretation.

The first, released on 3 April 2020 appeared to regard COVID-19 disruption as a temporary blip, which really shouldn't change treaty residence positions. The second, released as updated guidance (https://tinyurl.com/mr24vcyk) on 16 January 2021, recognised that the period of disruption had been longer than might have been expected initially, but allowed for very different interpretations of very similar fact patterns. For example, if someone returned to a home country from a host it could be regarded as a temporary move driven by the pandemic, so that the planned host country retained taxing rights; or it could be taken as illustrating that COVI/habitual abode remained in the first "home". This latter approach would normally mean that the country that had been expected to be the host location would cease to have any taxing rights at all on employment income unless work was physically undertaken there, as the individual would be treaty non-resident. Although the OECD guidance is quite nuanced, in practice a lot depends on how different fiscal authorities choose to interpret a fact pattern, and they may take quite different views of the same set of circumstances, and therefore have different views as to which country has taxing rights on income.

Where are we now?

If work was performed in a different location from that which had originally been expected, there was the potential for a whole host of tax and legal issues, as was highlighted in the recent Office of Tax Simplification's Call for Evidence and its report released on 20 December 2022 (https://www.gov.uk/government/publications/ots-report-on-hybrid-and-distance-working). Many of these issues remain and have left employers in the unenviable position of having to balance tax and legal risk with employees' requests to work in other countries. Most have managed this by setting guard rails and processes to manage employees' requests to work in a different country on a very short-term basis, but it remains an area of some tension, especially when potential recruits want to work remotely, or current employees want to negotiate a longer-term arrangement.

What is the impact for employers?

The challenges are numerous and wide as noted above, but from an employer compliance perspective, the key challenge may be around payroll compliance.

Where an individual has been assigned outside the UK, but returns to work from home in the UK it is possible that a treaty exemption will continue to be available as highlighted in HMRC's Appendix 4 agreement (https://www.gov.uk/hmrc-internal-manuals/paye-manual/paye82000). This specifically confirms that an individual who employed in the UK but assigned abroad may be reported as if employed by a non-UK employer, provided that he/she is economically employed outside the UK. However, if any return to the UK causes treaty residence to revert to the UK, any NT code issued by HMRC may be invalidated, as the onus is on employers to advise HMRC when any NT code issued may no longer be appropriate (see HMRC's internal guidance in PAYE81675 (https://www.gov.uk/hmrc-internal-manuals/paye-manual/paye81675)). So, it is vital for employers to know where their assignees are actually undertaking their duties, even if technology advances mean that the work itself can largely be done from anywhere.

In the opposite situation, where an individual is assigned to the UK, but manages to undertake certain of his/her duties in the home state, so as to remain treaty non-resident in the UK, his/her UK tax liability may be limited by a double tax treaty with the home state. However, if he/she is UK tax resident under the SRT he/she may not be eligible for a section 690 direction, and in law could easily be subject to full PAYE withholding. Thankfully, HMRC's helpful practice as detailed in PAYE81561 (https://www.gov.uk/hmrc-internal-manuals/paye-manual/paye81561) is to allow a similar direction to apply for treaty non-residents where an appropriate application is made. There may also be employer obligations to be considered in the remote work location.

Conclusions

While more flexible working patterns are likely to continue to be the new normal, in some cases they will also continue to present challenges for employers to overcome, particularly around payroll compliance. Where an employee's treaty residence position is also unclear, navigating the reporting obligations maelstrom internationally will be especially difficult, and obtaining appropriate technical advice is likely to remain key to managing the potential risks.

Eleanor Meredith

Eleanor has been a director in Deloitte's Tax Policy Group since June 2016, specialising in Global Employer Services and providing technical support to that part of Deloitte's UK tax practice.

Tax reliefs for homeworking and their limitations

Eleanor Meredith looks at some of the misconceptions around tax reliefs for homeworking

Introduction

Over the past couple of years, we have all got used to changing patterns of working and greater flexibility with those working patterns. For the years most affected by the pandemic through to 6 April 2022, we also largely enjoyed tax reliefs for home working that had never previously been utilised on such a scale. But while working patterns continue to evolve, the UK tax law on home working has not done so, and in some ways has gone backwards. This article considers why, and highlights some of the misconceptions around the reliefs available.

Working from home relief

FA 2003 first introduced a statutory exemption for the reimbursement by an employer of the extra costs of working from home, where there were formal homeworking arrangements which required the employee to work from home, at least part of the time. The exemption was not widely used, however, before the pandemic, as the use of home as a workplace had to be under formal arrangements. In addition, the exemption only prevented a tax charge where the employer reimbursed the cost, and did not allow any relief for employees bearing the extra costs themselves.

For the 2020/21 and 2021/22 tax years, HMRC took a much broader view of how the law applied. They effectively accepted that employees met the conditions for a deduction of homeworking expenses for the entire year under section 336, of costs being incurred *'wholly, exclusively and necessarily in the performance of the duties'*.

They did this by accepting that government instructions to work from home where possible were sufficient to mean that many employees were required to do this at some point, and rather than attempting to police individual claims and relevant periods for mandatory homeworking, they wisely opted to allow tax relief for all employees who were required to work from home for at least part of the tax year concerned. They, therefore, allowed a deduction for employees who bore the cost of homeworking personally, at a flat rate of £6 per week (or a larger amount, based on actual cost, if the employee could evidence that the £6 per week was insufficient). It may be debatable whether the costs claimed met the '*wholly, exclusively and necessarily in the performance of the duties'* test even for those years in most cases.

This relaxation was expensive for the Exchequer, and HMRC commented specifically in the April 2022 Employer Bulletin that although government restrictions were accepted as requiring homeworking for 2020/21 and 2021/22, this would not continue for 2022/23. Therefore, relief for unreimbursed homeworking expenses from 6 April 2022 onwards is only available where either:

- the role and its location are too far from an employer's premises for these to be a place of work for that particular employee, or
- there are no facilities available that would allow the employee to be based anywhere other than at home.

Where individuals relocated during the pandemic, they will not necessarily have changed the location of their workplace, especially where the relocation was their choice. So, not only will they often not be entitled to relief for home working expenses, but they will also risk being regarded as commuting, if they travel from home to what they now regard as a former place of work.

The element of choice

HMRC's view has always been that for an individual to be properly regarded as homeworking, it has to be an objective requirement of the role undertaken. The example cited in the Employment Income Manual (EIM32171 - https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim32171) of an individual training dogs to support the disabled underlines how difficult it may be for workers in more mainstream activities to show that they are objectively home-based.

If the objective requirement condition is not met, where an employee is not reimbursed by his employer for any extra costs associated with him working from home, he is unlikely to be able to claim tax relief on those costs, because in that case the law in section 336, ITEPA 2003 applies the stringent *'wholly, exclusively and necessarily in the performance of the duties of the employment'* test noted above. Expenditure on lighting and heating a house, and other similar costs, will rarely be incurred exclusively in performing the duties of the employment, even if an extra cost can be shown to have been incurred. Nor are such costs likely to have been necessarily incurred where alternative office space at an employer's premises could have been used. HMRC's commentary on this point is set out in EIM32825 (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim32825) and an example in EIM32830 (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim32830) illustrates the position.

Having said that, the exemption in section 316A, ITEPA 2003 allowing relief on homeworking costs reimbursed by the employer is broader, and HMRC will usually accept that an individual is entitled to the exemption if formal arrangements for homeworking exist. Relief for travel costs incurred from home is more difficult, as it will normally only be available where homeworking arrangements are imposed by the employer, and the employee does not have a choice in the matter. This requirement for the homeworking to be mandatory here has its basis in case law, and specifically in *Kirkwood* v *Evans* (EIM32374 - https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim32374), which confirmed that no relief was available to Mr Evans for his travel costs because in his case *'the homeworking scheme was optional. Mr Evans was permitted to work from home but he was not required to do so. He took up the option because for perfectly understandable reasons it was more convenient for him to remain at home for most of the week rather than to travel to Leeds. Working at home was not therefore a necessary incident of his employment.'*

If homeworking is not imposed, and the employer does not reimburse the extra cost of homeworking that would bring the section 316A deduction into play, tax relief will not normally be available, and many employees who qualified for some relief during the pandemic will not do so in more 'normal' times, because homeworking is no longer being mandated by government, and may not be required by an employer.

Even where the employer has imposed homeworking arrangements, HMRC may still regard travel between home and another workplace as ordinary commuting if they are not satisfied that the 'objective requirement' test would be met. Negotiating policies in this area continues to be a bit of a minefield for any unwary employers, and appropriate professional advice is highly recommended.

Easement for home office expenses

Under an exemption in section 316, ITEPA 2003, where an employer agrees to provide supplies and services (eg office equipment) that will allow the employee to perform the duties of his employment otherwise than on the employer's premises, no tax charge will normally arise provided that:

- The supplies and/or services are provided for the sole purpose of enabling the employee to perform the duties of the employment and
- The individual uses them in performing the duties of the employment, and any use for the employee's private purposes is not significant.

Examples of the sorts of items that may be covered include:

- office furniture and equipment such as desks, filing cabinets, chairs etc.
- stationery and normal office or workshop materials and supplies
- home telephone lines in some circumstances and

- computer equipment.

Relief is only available where the employer retains the ownership of any assets concerned. If ownership is transferred to the employee, it will usually become a taxable benefit. If the employment ceases, this can leave employers in the uncomfortable position of having to reclaim dilapidated and fully depreciated equipment that will cost more to retrieve than its inherent value, because if they fail to do so, the employee concerned is likely to suffer a tax charge, based on the value of the equipment transferred when it was first provided.

In addition, the way in which the provision of equipment is arranged is important. Any reimbursement of home office expenses by an employer is likely to be a repayment of private expenditure and will need to be taxed via payroll to account for tax and NIC appropriately.

During the pandemic, relief was made available by two means:

- a temporary easement allowing reimbursement of home office expenses applied by Regulations in the period from 11 June 2020 to 5 April 2021; and
- HMRC also exercised their discretion not to pursue liabilities on reimbursed home office expenses paid between 16 March and 10 June 2020.

But both these relaxations have now ended. Employers who allowed relief under the Regulations may find it hard not to offer a similar mechanism for new recruits, or may simply find it uncommercial to track and recover old equipment; but they will have to account for associated tax costs if they wish to take a more pragmatic approach.

What might the future hold?

Many of the issues highlighted above also had a mention in the Office of Tax Simplification's (OTS's) recent report on hybrid and distance working as aspects that cause employers some difficulty and where reform may be needed. Whether government is minded to consider this further at this stage remains to be seen, but there are many other aspects of the existing law where some reform would be welcome, including policies allowing employers to subsidise green forms of commuting travel.

If wider reform of the law itself is not a current option, employers would still welcome more flexible means of reporting cash reimbursements than strict payroll reporting, and there would seem to be little mischief in allowing PAYE Settlement Agreements to be used as a pragmatic alternative in these sorts of circumstances.

Eleanor Meredith

Eleanor has been a director in Deloitte's Tax Policy Group since June 2016, specialising in Global Employer Services and providing technical support to that part of Deloitte's UK tax practice.

Electric Cars – reimbursement of employee expenses and reclaiming VAT

Peter Moroz looks at some of the tax complexities that arise when recharging an Electric Vehicle used for business travel

Since writing last year, the Advisory Electric Rate has increased again on 1 December 2022 from 5ppm to 8ppm in December and 9ppm in March. Most analyses in industry report that this is still inadequate.

The true rate many see is between 10.5ppm (home charging) and 19.1ppm (Motorway charging). The rate does depend on the ability of the car in question to convert Kwh into miles and a typical rate of 4 miles /Kwh has been assumed.

The home charging cost of 10.5ppm assumes no input VAT recovery, which is in line with HMRC guidance. It is the question of VAT recovery that I want to explore a little more.

HMRC position in 2021 - Per Revenue and Customs Brief (7 – 2021)

On the subject of VAT recovery for ***employees charging an electric vehicle (which is used for business) at home*****,** there is the stark message from HMRC:

"*You cannot recover the VAT. This is because the supply is made to the employee and not the business.*"

However, this is totally at odds with HMRC internal manual VIT13400 which specifies when input VAT can be reclaimed by the business on supplies generally to employees. Specifically, it gives "*examples of supplies which are to be regarded as made to the employer (provided the employer meets the full cost) even when it may look as if the employee has received the supply:*

This includes road fuel and other motoring expenses…. "

The guidance goes on:

"*You should decide whether the supply is legitimately paid for by the employer for the purposes of the business. If it clearly is then input tax should be recovered. This is in keeping with the intent of the legislation.*"

HMRC position in January 2022

HMRC announced that they were reviewing the VAT position where an employee is reimbursed by the employer for the actual cost of electricity used to charge a car.

The details of the change in position were set out in **Motoring expenses (VAT Notice 700/64)**

8. Electricity for charging electric vehicles

8.1 Who can reclaim input tax

VAT incurred by businesses when charging electric vehicles can be recovered on the business use of those vehicles, where the vehicles are charged at work or at public charging premises.

You can also recover the VAT for charging your electric vehicle if you're a sole proprietor or a partner in a partnership business, and you charge your electric vehicle for business purposes at home.

You should work out how much of the cost of charging your electric vehicle is for business use and how much is for private use by keeping mileage records. The normal input tax rules then apply.

8.2 Employees charging an electric vehicle which is used for business at a public charging point

If an employee charges an electric vehicle (whether this is a company vehicle or not) at a public charging point, the supply of electricity is made to the company or employer. They can recover the VAT on the cost of charging the electric vehicle, subject to the normal rules.

The employer must keep detailed mileage records to work out how much of the charging cost is used for business and private purposes where applicable.

8.3 Employees charging an electric vehicle which is used for business at home

Where an employee charges an electric vehicle (whether this is a company vehicle or not) at home, the overall supply of electricity is made to the employee and not the employer.

The employer is not entitled to recover the VAT on the cost of charging the electric vehicle.

8.4 HMRC review

8.4.1 Electricity paid for by employees

We are considering the situation where an employee is reimbursed by the employer for the actual cost of electricity used in charging an electric vehicle for business purposes.

This is to determine what evidence can be practicably provided, to allow the employer to claim the related VAT, subject to the normal rules.

8.4.2 Simplification measures

We are also considering other simplification measures that may reduce administrative burdens in terms of accounting for VAT on private use.

Some thoughts on this:

The statement in 8.3 contradicts what follows in 8.4 and is still at odds with the internal guidance on motoring expenses This is not surprising when you consider that 8.3 reflects the old HMRC position and 8.4 is a statement to the effect that there is recognition that 8.3 is probably not correct.

8.4.1 quite sensibly suggests that VAT is indeed recoverable and it is just a question of the evidence required to link the cost of actual charging to the mileage driven for business. One would imagine that what might, for instance, be adequate is a combination of a record of the proportion of total mileage driven for business, associated with the home electricity cost and VAT incurred by the driver.

8.4.2 implies that there is also some thought being given to the situation where an employer pays for all electricity for charging a car (i.e. both for business and private mileage) and recovers all the input VAT (which is typically what employers are doing for workplace charging). The strict position currently is that the employer should be restricting the input VAT on their electricity cost by reference to the proportion of mileage that is business. A simplification may therefore be in the form of a VAT fuel scale charge equivalent for Electric Cars i.e. a fixed amount per vehicle; similar to the regime for non-electric cars where a fuel card is provided.

A further simplification would be to allow VAT recovery by reference to the (albeit inadequate) figure of 9ppm for business mileage. A debate here may ensue on the rate of VAT to allow recovery upon- 5% or 20% given that some charging may have taken place at home and some at a work or at a public chargepoint.

A further point along the same lines is the situation where an employer pays for all electricity (home, workplace and motorway charging) and then requires the employee to repay (at say 9ppm) the cost of private mileage. In this situation the payment by the employee is VAT inclusive but what is the appropriate rate of VAT? It would seem most inequitable for VAT on an employee recharge to be at a higher rate than that at which it was incurred.

So what, you may ask, is the position some 14 months later in March 2023?

Well, sadly, nothing has moved on. The review, I am assured, is ongoing but as for a date when further guidance will be issued, nothing is forthcoming. Not even a date by which HMRC will know the date.

However, given the tone in 2022 of HMRC, it seems to me that there is tacit acceptance that VAT on home charging electric cars is already recoverable (insofar as it relates to business mileage). We are simply left to guess what is acceptable evidence. Given that it can only be a combination of mileage records and evidence of VAT charged at home, that is what I would suggest be retained.

Peter Moroz

Peter Moroz is Chairman at Innovation Financial Consultancy LLP & sits on the CIOT Employment Taxes Committee. Innovation are specialists on all aspects of Cars; Tax & Mileage Tracking including change management / communication strategy, and project implementations.

Managed Service Companies – Where are we now?

Rob Woodward discusses HMRC's current approach to Managed Service Companies (MSCs) and its interpretation of an MSC provider

The Managed Service Company (MSC) legislation was introduced in 2007 and while it resulted in significant changes for some businesses and their practices at the time, since then it has served as a piece of legislation that has remained largely untested.

There has however been gathering momentum in some quarters in response to recent HMRC compliance action. This article gives an overview of where matters currently stand and what advisers should be looking out for.

Background

As a starting point it is useful to recall the genesis of the MSC legislation (Section 61A-J, ITEPA 2003) which was introduced as a response to a Government perception that there were a significant number of arrangements in place intended to avoid PAYE/NIC and the existing IR35 legislation through providers setting up managed personal service companies (PSCs) for contractors who might otherwise have been taxed as employees. The Government considered that a whole industry had developed whereby providers were forcing contractors into managed PSCs by taking-on contractors and creating PSCs simply to save tax.

The aim of the legislation was not to focus on the contractors or their PSCs as the intention was not to replace the IR35 legislation (Section 49 ITEPA 2003) because the Government's view was that the IR35 rules applied to MSCs but were being ignored – hence the introduction of the MSC legislation to address the risk to the exchequer. Instead, the MSC legislation focussed on the relationship the MSC providers (and any associates of the providers) had with the contractors and how they engaged with them when dealing with their PSC or helping them set one up.

How the legislation works

For the MSC legislation to apply there first needs to be a Managed Service Company Provider (MSCP) involved in any arrangements. This is an organisation or person who "*carries on a business of promoting or facilitating the use of companies to provide the services of individuals*" (Section 61B ITEPA 2003) and either benefits financially on an ongoing basis from the provisions of services of the worker, influences or controls those services, influences or controls the way in which payments are made, influences or controls the PSC's finances/activities or underwrites any tax loss suffered by the PSC.

Within the legislation there are exemptions (Section 61B(3) ITEPA 2003) where the purported MSCP is merely providing legal or accountancy services in a professional capacity or is solely placing individuals at third parties (for example employment businesses acting as an introductory agent). Where the exemptions apply that business will not be considered an MSCP and if there is no MSCP then crucially the MSC legislation cannot apply.

Another key concept is that, where the MSC legislation applies, while the assessment of tax/NIC due will be raised by HMRC on the contractor, if the contractor is unable to settle the tax/NIC due then HMRC can transfer the debt to other parties including the MSCP. If a debt is transferred there are limited grounds for the MSCP to appeal against the transfer and in practice the most effective appeal would be in tandem with the contractor's appeal that the tax/NIC was not due in the first place – something that will require careful management.

What has changed?

As far as the legislation itself, nothing has changed since it was enacted. However HMRC now have a precedent set in a case centred on the MSC legislation through *Christianuyi Ltd & Ors* v *Revenue And Customs* where HMRC were successful in both the First Tier Tribunal ([2016] UKFTT 272) and the Upper Tribunal ([2018] UKUT 10) and importantly at the Court of Appeal ([2019] EWCA Civ 474). Consequentially, HMRC have looked to apply this precedence more widely.

The landscape of accountancy services has also changed significantly since 2007, particularly for those accountants focusing on the contractor market. Since 2007 these services are significantly more digital and increasingly accountants and their clients interact electronically, often via information uploaded through portals for the generation of electronic returns. Much of this has been driven by Government requirements to file electronically for example iXBRL tagging, RTI payroll filing and Making Tax Digital. This means that accountancy practices operate differently to how they did in 2007 but without HMRC necessarily appreciating this.

What are the central points of HMRC's current approach?

Of course these are general comments gathered from an understanding of information publicly available in the accountancy and recruitment sector press on the open enquires and clearly every case needs to be judged on its merits which limits the value of some of the general observations made. However it appears there are two key themes affecting HMRC thinking:

1. HMRC are trying to apply the *Christianuyi Ltd & Ors v Revenue And Customs* more widely, and

2. HMRC are seeking to argue that businesses relying on the exemption to being an MSCP by providing legal or accountancy services in a professional capacity cannot necessarily rely on that exemption.

On the first point, clearly no two cases are the same. Indeed no two contractors or their relationship with their advisor are the same. In many respects *Christianuyi Ltd & Ors* was an outlier in that the facts of that case are not a reflection of wider trends and, importantly, at no point did the purported MSCP in question seek to rely on the legal or accountancy services exemption. While HMRC are of course at liberty to take on whatever case they wish, success in one case does not automatically mean success across a whole sector.

The bigger concern relates to the second point on the legal and accountancy services exemption. In the run up to April 2007, many organisations undertook assessments to gauge their readiness for the MSC legislation coming into force and took appropriate corrective action. This resulted in a number of organisations becoming or rebadging themselves as accountants (with of course adjustments to their operating model). Many of those providers hired and trained accountants and joined accountancy professional bodies, which included signing up to their codes of conduct and regulatory regimes. In other words, they operated as specialist accountancy firms, with a focus on the contractor market but not as businesses establishing PSCs for the sole purpose of potential tax savings.

It has now been over 15 years since the legislation went live and while the modus operandi of a typical accountancy provider has evolved, the legislation and the mischief it was envisaged being addressed has not. In that respect there may be some degree of misunderstanding on HMRC's part as to how accountants operate, particularly when the client is a contractor. Many specialist accountants focussing on serving contractors (colloquially known as contractor accountants) have a model that involves the accountant advising on appropriate structuring of the contractor's business, albeit that generally (but not always) contractors will incorporate their business to both take advantage of potential tax breaks and to ring-fence risks. However, HMRC's rather more narrow view appears to be that by the contractor incorporating the business, and the contractor accountant assisting with that incorporation, then the accountant is influencing or controlling the way the worker is paid - and that this may be sufficient to meet the test in Section 61B(2) of being "involved with the company". But this does not recognise that a well-run contractor accountant will advise based on the client's position and indeed, where circumstances are more appropriate, advise <u>not</u> to incorporate.

In particular, HMRC seem to have interpreted the standard operating model of contractor accountants as something driven by tax rather than client service. While the general approach these days is that the client accesses the accountant's services via a portal, which both reflects the modern preference for electronic communication and also allows the accountant to receive the relevant information in electronic form to link in with relevant software to enable online filing of returns, HMRC's view is that this indicates that the accountant is controlling the PSC's activities.

Furthermore, the contractor will typically sign up for the services on the basis they are paid for monthly in instalments via direct debit in anticipation of the accountant filing their tax returns, annual accounts, running payroll etc. The rationale for this is to smooth out the costs to ease cashflow – there would be monthly payroll running costs but certain months (for example January when tax returns are filed) would see larger fees if this smoothing didn't take place. However, it appears to be HMRC's opinion that monthly billing is "*benefit[ting] financially on an ongoing basis from the provision of services*".

In any event, taking on board HMRC's thinking, the consequence of the modern commercial working practices typically adopted by contractor accountants, as opposed to the less automated traditional 20th century approach, is likely to be an increasing number of HMRC enquiries and assessments, both in relation to MSCs and their contractor accountants.

As assessment windows for enquiries under the MSC legislation are, normally, limited to up to the most recent four tax years (extended to six years if the 'failure' is considered 'careless or deliberate behaviour' and as a tax year ends so an earlier tax year falls out of scope for assessment then, unless HMRC raise "protective assessments", this means there could be further assessments each year until the matter is resolved. These assessments are particularly concerning because it could well be that the contractor accountant is ultimately in the firing line, ie the assessments are made on the contractor but with a subsequent transfer of debt to the contractor accountant as the purported MSCP –and with limited scope for the contractor accountant to appeal against the MSC legislation applying.

What should contractor accountants and contractors be doing?

The main point is to be vigilant and not rely on historic practice. Instead contractor accountants should review their position and take advice as necessary to ensure that they aren't getting close to HMRC's view of being an MSCP. Contractors should ensure that their accountant looks and acts more like an advisor and that the contractor makes all relevant decisions – albeit based on best practice advice received. Changes contractor accountants made in 2007 intended to avoid being deemed as an MSCP may have evolved with modern working practices, but without the necessary reflection as to whether this evolution could potentially undermine their case currently that they are not an MSCP, at least in HMRC's view. This is both a reminder and a good opportunity to reassess practices to determine whether the organisation is considered an MSCP.

Of course if assessments are received by contractors, they should take advice and appeal within the 30-day time limit if they don't agree with the tax liability being assessed. Contractor accountants should react accordingly taking note of the fact that it will be the client who needs to appeal but due to the transfer of debt risk the contractor accountant has a vested interest in those appeals being made in a timely manner and on sensible technical grounds.

Another key message is to keep abreast of developments – this is a current live issue and evolving rapidly (in tax terms anyway) so being flexible and adaptable is important to avoid getting into hot water.

For a contractor, the best question they can ask themselves is "does it feel like I'm dealing with an accountant providing tailored advice to my individual circumstances or does it feel like I'm being sold a set product and expected to fit into their way of doing business?"

If contractor accountants can't answer this question comfortably or feel that they could withstand any HMRC review, they should review the current arrangements to determine whether this presents a risk under the MSC legislation. For businesses that have already received notification from HMRC that they are under enquiry, this should be taken extremely seriously.

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Employment intermediary or onshore agency rules

Lee Knight and Susan Ball from RSM UK discuss what employers need to know about the agency and temporary workers legislation ('the agency rules')

Key points

What is the issue?

When an off-payroll worker is not operating through an intermediary they own and manage (such as a personal service company (PSC)), and their services are provided to a client under a contract that the client has with a third person (the agency), the agency rules need to be considered.

Many organisations do not realise they can be considered an agency for the purpose of the agency rules just because they have a contract with another party to provide the services of someone who is not their employee, or a worker from whom they are not deducting income tax and National Insurance contributions (NICs) under PAYE.

To add further confusion, for those involved in construction, the agency rules should be considered in priority to the construction industry scheme (CIS) provisions, and there are also separate rules where an offshore entity is involved.

What does it mean for me?

When the onshore agency rules apply the worker is treated as holding an employment with the agency which has the direct contractual relationship with the client. This means that agency must deduct income tax and NICs under PAYE when paying that worker. However, the liability for the tax and NICs due under PAYE, and the responsibility to operate PAYE, can pass to the client and others in the labour supply chain in certain circumstances. For example, the end-client can be held responsible for the tax and NIC due where they provide incorrect information stating there is no supervision, direction, or control over the manner in which the worker goes about their work.

The agency must keep records and make quarterly returns of individual workers provided to clients, when they are not responsible for deducting income tax and NICs at source through PAYE.

The agency rules are often overlooked or misunderstood, and it is not necessary for a person to be an agency in the ordinary sense for the rules to apply. Undertaking due diligence and understanding the labour supply chain is therefore key. Failing to do so can result in employment tax obligations being overlooked, and a failure to submit returns. The agency, the end-client, or another party in the labour supply chain, can then be liable for underpaid tax and NICs liabilities and HMRC penalty charges, and could also be exposed to other legal and reputational risks.

Introduction

Where off-payroll workers provide their personal services through third parties such as agencies, umbrella companies, or another person, it is crucial to understand the supply chain, including who the workers are engaged by, and how that party will engage with and pay the workers. They also need to know whether the supply chain involves offshore or onshore entities, as different rules may apply.

Failing to do this can result in key employment tax obligations being overlooked, and the end user of the off-payroll worker's services (the client), or another party in the labour supply chain, being liable for underpaid tax and National Insurance contributions (NICs) liabilities. It could also expose them to HMRC penalties and other legal and reputational risks.

There is also the risk of the business failing to meet its obligations under the Criminal Finances Act 2017, potentially leading to a criminal conviction with an unlimited fine, and brand, reputational and commercial damage. For larger businesses, where the senior accounting officer (SAO) legislation in Schedule 46 Finance Act 2009 applies, failure to meet the business's obligations under that legislation may also lead to reputational damage and financial penalties for both the business and the SAO.

This is particularly topical at present, given the increasing use of umbrella companies to provide temporary workers, and HMRC's recent focus on non-compliant umbrella companies operating tax avoidance schemes, and on off-payroll working in general.

The introduction and extension of the reformed off-payroll working (OPW) administrative rules (commonly known as IR35) from 6 April 2021 certainly complicated the position, and while obligations under OPW are an important consideration, the focus should not only be on OPW compliance.

Recent cases such as K5K Ltd v HMRC [2022] UKFTT 217 (TC) (https://tinyurl.com/sucsdfev) show that HMRC will not disregard the agency rules simply because the worker is purportedly operating through a personal service company. HMRC's Employment Status Manual (at ESM2017 - https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2017) is alert to this, stating that: *'The [agency] legislation is not avoided simply by including the [personal service] company's name on a contract obviously meant for use by an individual or by arranging for payment to be made to the company.*'

When an off-payroll worker is not effectively operating via an intermediary they own and manage (such as a personal service company (PSC)), and their services are provided to a client under a contract the client has with a third person (the agency) the agency rules need to be considered. These agency rules are often overlooked or misunderstood, and it is not necessary for a person to be an agency in the ordinary sense for the rules to apply.

What are the onshore agency rules and when do they apply?

The agency rules applicable from 6 April 2014 are located within ss44-77 (Chapter 7) Income Tax Earnings and Pensions Act (ITEPA) 2003 (https://tinyurl.com/2p8mv6rt) (for income tax) and the Social Security (Categorisation of Earners) Regulations (SI 1978/1689) (https://tinyurl.com/bddzshbs) (for NICs). This article focuses primarily on the tax rules, which the NICs provisions broadly follow.

The agency rules apply when:

- the worker personally provides services (which are not excluded services) to another person (the client);

- there is a contract between the client (or a person connected with the client) and a person who is not the worker, the client, or a person connected with the client (hereafter referred to as the agency, although it is not necessary to be an agency in the ordinary sense);

- in consequence of that contract either the worker's services are provided, or the client or any person connected with the client pays, or otherwise provides consideration for, those services;

- the worker is subject to (or to a right of) supervision, direction, or control by any person as to the manner in which they provide their services; and

- remuneration receivable by the worker in consequence of providing the services does not constitute employment income before the provisions of the agency legislation are applied.

For those using subcontractors to undertake construction operations these rules must be considered in priority to the construction industry scheme (CIS) provisions.

What is the effect of the rules?

Where the above criteria are all met, the worker is treated as holding an employment with the agency that has the direct contractual relationship with the client, and that agency must deduct income tax and NICs under PAYE when paying that worker.

It is important to note, however, that the liability for the tax and NICs due under PAYE, and the responsibility to operate PAYE, can pass to the end-user in certain circumstances. This may be the case in a number of scenarios.

- If the agency's client pays the worker directly, the client must deduct tax and NICs under PAYE in respect of the payments made to the worker.

- Where a worker is employed or engaged by or through an offshore intermediary or agency and works for a UK end-user but there is no UK agency in the contractual chain, the client that the person works for is treated as the employer responsible for operating PAYE, where this is required. If there is a UK agency present in the labour supply chain the responsibility to deduct tax and NICs under PAYE will lie with the UK agency.

- When an agency is provided with documents by the end client or another relevant person which state that the agency rules do not apply, and these documents are found to be fraudulent, the liability to operate PAYE, where required, transfers to the person who provides that fraudulent documentation (see ESM2044 - https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2044**)**. This might be where the end-client provides or signs a document which incorrectly states that there is no supervision, direction, or control as to the manner in which the worker provides their services.

The obligation to deduct tax and NICs when the agency rules apply does not, therefore, always fall with the agency that has the contract with the client. End-clients can be caught too, as can others in the labour supply chain.

What are excluded services?

These are services where:

- it can be shown that the worker is not subject to (or to a right of) supervision, direction, or control by anyone in relation to the manner in which they provide their services - HMRC's position is to presume that there is such supervision, direction, or control over the worker unless it can be demonstrated there is not; or

- the worker provides their services wholly in their own home, or on other premises which are not controlled or managed by the client, unless the worker is required to do so at those premises because of the nature of the services and work being provided; or

- the worker provides their services as an actor, singer, musician, or other entertainer or as a fashion, photographic or artist's model.

In addition to the above, if the remuneration the worker receives for providing the service is otherwise chargeable as employment income before the agency legislation is applied, the agency rules do not apply. For example, where the worker is employed by an umbrella company further down the labour supply chain, and it is operating income tax and NICs under PAYE in the normal way when paying the worker.

It is also worth noting that, where the agency simply puts people forward to be considered for roles for a fee, and the contract for the work is between the worker and the client, the agency provisions do not apply. Instead, the employment status tests should be considered by the client in relation to its contract with the worker if they are not employing them (see ESM2012 –
https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2012).

Do the rules only affect agency businesses providing named individuals?

The rules can have a wide impact and it is not necessary for an individual worker to be named in the contract. The rules must be considered in respect of the circumstances of any worker providing their personal services in fulfilling such a contract.

Furthermore, the rules do not just apply to agencies: other businesses and organisations can be caught. The legislation can apply when the contract between the client and the agency includes the provision of goods and services. In this respect:

- an agency is a third party interposed between the worker and the client for whom the worker is providing services; and

- a client is the party for whom the worker is providing services.

What is supervision, direction, or control?

The supervision, direction or control test focuses only on the manner in which the worker carries out their work. In other words, is there supervision, direction, or control (or a right of supervision, direction, or control) over how they perform their services?

This is narrower in scope than the control test for status assessment purposes, which deals with control over what the worker does, how they do it, where they do it, and when. Even so, it is still necessary to have a thorough understanding of the broader arrangements.

The test is also met where there is a right to exercise supervision, direction, or control over how the worker does their job, even if that right is not exercised in practice.

Only one part of the test needs to be met. So, for example, if a worker is subject to supervision, or if there is a right of supervision despite the worker not being supervised, but they are not subject to direction or control, the test will be satisfied.

The test is not dependent on who exercises (or has the right to exercise) supervision, direction, or control over how the worker performs their services. It need not be the client: it could be the agency, someone else in the supply chain, or another person.

The extent of supervision, direction or control is also irrelevant, which again distinguishes this test from the general control tests for status assessment purposes. For agency rule purposes, the test either is or isn't met, so even the smallest amount of supervision, direction, or control over how the worker performs their services could be decisive.

The agency legislation can therefore apply to workers who, if working directly for the client, would have otherwise been regarded as self-employed for tax purposes when applying all the normal employment status tests.

HMRC states in ESM2037 - https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2037: '*Where a worker is engaged by or through an agency, there will be a presumption that there is (or there is the right of) supervision, direction, or control over the worker.*' HMRC's interpretation of key words can be summarised as follows.

- Supervision is the action or process of watching or overseeing what a person does, or how it is done. This also covers situations where supervision is present to help the worker develop their skills and knowledge. So, in HMRC's view, if someone checks, or has the right to check, the work to make sure it meets a required standard, the way the worker provides the services will be subject to supervision.
- Direction is the action of making the worker perform their work in a certain way by providing them with instructions, guidance, or advice on how the work must be done.

- Control is the action of instructing a worker on how they do the work. It also includes someone having the power to move the person from one job to another.

The following should also be noted in relation to HMRC's interpretation of the rules.

- If there are procedures, methods and instructions that must be followed by the worker, HMRC's view is that they will regard the supervision, direction, or control test as being satisfied.
- Generally, where a worker operates in an industry where the way they work is governed by regulations or another form of statutory framework or standard, they will be subject to supervision, direction, or control over how they work. This is because somebody will have the right to check that their work complies with those standards.
- However, just being required to comply with general statutory requirements like health and safety procedures isn't necessarily indicative of there being a right of control over how the worker performs their services, as all workers (employed or self-employed) must comply with these requirements.
- Agency workers in industries that are regulated by statutory bodies are subject to supervision, direction or control, because somebody will have the right to check that their work complies with relevant regulatory standards. This includes health and social care workers, teachers and teaching assistants.

As highlighted above, satisfactory evidence should be retained to demonstrate (where applicable) that the worker is not subject to (or to the right of) supervision, direction, or control over how they work. A signed declaration from the worker is not sufficient evidence. HMRC is likely to test such evidence when considering whether the agency rules have been complied with.

Information on how HMRC considers these rules apply in relation to partners or professional workers can be found at ESM2010 - https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2010 and ESM2014 - https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2014.

Example - Ben

Ben is engaged by a bathroom company to supply his services as a fitter.

The company has agreed a contract with a client to supply and fit bathrooms in a residential development. Under that contract the company supplies all the bathroom fittings, materials, accessories etc, and agrees to provide a fitter. The client is not aware of which fitter will be supplied.

Ben will fit the bathrooms and then invoice the bathroom company for his services as a sole trader business. Ben has gross payment status as a construction industry scheme (CIS) subcontractor, and the company intends to pay Ben without a CIS deduction and report the payments to Ben on its CIS returns. The company invoices its client the agreed fees under the terms of its contract with the client when completed.

In terms of the agency rules:

- *Ben is personally providing his fitting services to the client;*
- *there is a contract in place between the client and the bathroom company;*
- *because of that contract, Ben personally provides his bathroom fitting services to the client; and*
- *the client pays for those fitting services under the terms of its contract with the bathroom company (which also included the supply of goods).*

The agency rules could therefore apply. The bathroom company will need to consider whether the other conditions in the agency legislation are satisfied, including whether Ben is subject to (or to a right of) supervision, direction, or control as to the manner in which he performs his work (see below).

The client of the bathroom company requires the fitting work to be completed to a very high standard. The client has a project manager on site who instructs Ben on how to install the fittings and then carefully checks the work to ensure the desired standard is met. On occasions the project manager is of the view that adjustments are required and so instructs Ben on a different way of installing the bathroom fittings. The project manager supervises Ben as he is making those adjustments and then checks the final work. The contract between the bathroom company and the client gives the client the right to do this and there is supervision, direction, or control over the manner in which Ben will perform his services.

The bathroom company will be treated as Ben's employer and should deduct income tax and NICs under PAYE when paying him.

If the agency rules did not apply, the bathroom company should also consider whether Ben is regarded as an employee under the normal rules for assessing status. This needs to be considered and established before applying CIS and would form part of the declaration on the CIS monthly return.

Are there reporting requirements?

Regulations 84E–84H were added to the Income Tax (Pay As You Earn) Regulations 2003 (https://tinyurl.com/565zxexn) from 6 April 2015, introducing an additional reporting requirement for employment intermediaries relating to workers for whom they have not operated PAYE.

The agency must keep records and make returns for individual workers provided to clients when income tax and NICs have not been deducted at source through PAYE by the agency. The report should cover workers provided to clients where the worker is operating via an intermediary they own and manage, such as a PSC.

Returns must be made to HMRC on a quarterly basis using HMRC's report template with the first quarter for each tax year starting on 6 April, and there are penalties for late filing and incorrect returns.

Are there also special rules in relation to travel and subsistence?

Workers who provide personal services to clients via 'employment intermediaries' are subject to separate rules and restrictions on claiming tax relief on expenses they incur in travelling to and from their place(s) of work. Under these rules, contained in section 339A ITEPA 2003 (https://tinyurl.com/5afypjud), each client engagement is seen as a stand-alone employment, so each workplace they attend for each client engagement is likely to be treated as a permanent workplace for tax purposes. That means their travel and subsistence expenses for travelling to those sites are unlikely to qualify for tax relief. There are some exceptions to these rules which need to be considered on a case-by-case basis.

Summary

Given that HMRC is actively investigating off-payroll working arrangements, end-clients and agencies should, as a priority:

- undertake labour supply chain due diligence to ensure that all engagements falling within the various off-payroll (including agency, managed service company etc) rules are identified and appropriate checks undertaken;
- ensure internal teams and hiring managers have sufficient ongoing training to raise awareness of the rules and reduce the risk of non-compliance, and demonstrate reasonable care has been taken to comply;
- consider revisiting how the organisation undertakes status determinations, including checks on supervision direction and control, in light of updates to the working arrangements and the latest case law; and
- review the evidence kept of the checks undertaken and compliance with the various rules, and ensure it is sufficient to minimise any risk of non-compliance.

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Net pay or relief at source? Tax relief on employee contributions and workplace pensions

Susan Ball and Joe Pickering discuss issues with workplace pensions, and mistakes in operating tax relief on employee contributions

Employers must take care that tax relief on employee pension contributions via the payroll is not given when it's not due. Mistakes can be expensive and complicated to correct.

It is therefore important that employers and advisers check what type of tax relief the pension scheme has been set up to operate. A scheme can only use one method of tax relief for all members, and this affects lower or higher paid employees in different ways.

Background

It is important to note that here we are considering only registered pension schemes, that is pension schemes that have been registered by HMRC under sections 153 to 159 of the Finance Act 2004. Unregistered pension schemes do not enjoy the same tax treatment that registered schemes do.

Most workplace pension schemes are now defined contribution schemes. Contributions are made by the employee and/or the employer, and the pension fund hopefully grows through these contributions and through the return on investment.

There are two different ways that employees can obtain tax relief on their employee pension contributions to defined contribution pension schemes depending on how the scheme has been set up. These two types are 'relief at source' and 'net pay'.

This shouldn't be confused with the fact that some employers operate their workplace pension arrangements in conjunction with salary sacrifice or salary exchange. While salary sacrifice may work like a net pay arrangement, in that the salary sacrificed/exchanged reduces taxable pay like an employee contribution under a net pay arrangement does, it is a very different type of arrangement. An effective salary sacrifice/exchange reduces contractual salary and in turn pay liable to tax and Class 1 National Insurance contributions. Whereas an employee contribution made under a net pay arrangement reduces only taxable pay.

Terminology

It is important to understand the difference between 'relief at source' and 'net pay' arrangements.

1. Relief at source

Where 'relief at source' applies, employee contributions do not reduce taxable pay under PAYE. The employer deducts only 80 per cent of the total employee contribution from the employee's net salary, pays this to the pension scheme, and basic rate tax relief is then added to the fund by the pension scheme, which the scheme reclaims from HMRC.

If the employee is a higher rate taxpayer, they can also separately claim higher rate tax relief personally, either through their self-assessment tax return or by making a claim to HMRC. Depending on their circumstances the higher rate tax relief will reduce the tax bill, give them a tax refund, and/or result in a change to their PAYE tax code (reducing the tax paid at source on their salary for the tax year the PAYE tax code relates to). One thing to note is that they will only get the higher rate tax relief on the income that has been taxed above the basic rate band.

2. Net pay

In a 'net pay' scheme, 100 per cent of the employee pension contribution is deducted by the employer and paid to the pension scheme. This employee pension contribution reduces the employees taxable pay under PAYE.

This means that the employee pays tax on their salary *after* their pension contribution is deducted. In other words, the employee pays tax on a salary which is 'net' of their pension contribution, meaning that they automatically receive tax relief via the payroll at their highest rate of income tax.

The pension scheme does not claim additional tax relief, and there is no need for the employee to separately claim higher rate tax relief personally.

A registered pension scheme can only accept contributions that have been relieved through net pay arrangement in 2 situations, namely under:

- Section 191(3) Finance Act 2004 where the pension is an occupational pension scheme, the member is an employee of a sponsoring employer, and relief is given in the same way for all members of the scheme who are employees of the sponsoring employer: or
- Section 191(4) Finance Act 2004 where the member is an employee, and the pension scheme is a public service pension scheme or a marine pilots' benefit fund (as defined in Section 191 (8) Finance Act 2004).

However, employees in a net pay arrangement, will not get any tax relief if their income is below the personal allowance (£12,570 for the 2022/23 tax year). The effect is that low earners with earnings below the personal allowance in net pay arrangements have less take-home pay than they would if they were saving into a pension scheme that uses relief at source. In the 2021 Autumn Budget the government announced that individuals in this situation will be entitled to a top-up payment, equal to the tax relief they have missed out on, with effect from the 2024/25 tax year. HMRC should notify those eligible and invite them to provide the necessary details for the top-up to be paid into their bank accounts.

Schemes which use each tax relief method*

Relief at source	Net pay arrangements
National Employment Savings Trust (NEST)	Creative Pension Trust
The People's Pension[1]	The Crystal Trust
True Potential Investments	NOW: Pensions
Standard Life Workplace Pension[2]	Smart Pension Master Trust
	The Lewis Workplace Pension Trust
	Workers Pension Trust

[1] Relief at source is the default, but some employers may have chosen to use net pay instead.

[2] Large employers may be using the trust-based scheme, which uses net pay (group personal pensions use relief at source).

*See https://www.thepensionsregulator.gov.uk/en/employers/new-employers/im-an-employer-who-has-to-provide-a-pension/choose-a-pension-scheme/what-to-look-for-in-a-pension-scheme.

What is the issue?

The above terminology is confusing and easily misunderstood.

It is therefore relatively easy for employers (or their outsourced payroll teams) to incorrectly set up their workplace pension schemes on their payroll. For example, to operate a 'net pay' arrangement when it should be 'relief at source' tax relief, so that 100 per cent of the employees' pension contributions are deducted from their salary before income tax is calculated under PAYE. The pension scheme may then also add the tax relief when the employee pension contributions are paid into the pension fund and reclaim this from HMRC. So, tax relief has mistakenly been given twice!

Added to this some employers are not clear on what is considered in their scheme to be pensionable pay. For example, is it basic pay only or does it include bonuses, commissions or even car allowances?

We have seen examples of mistakes happening on set up, or where there is a change in payroll provider, and the wrong box on the payroll set-up form is ticked because the person completing the form misunderstood the terminology.

Where this happens, especially over an extended period covering multiple tax years, it can be difficult to correct what has gone wrong because:

- The employer won't have subjected the correct amount of earnings to tax under PAYE, and HMRC will hold them responsible for the underpaid income tax. If the employer has not exercised reasonable care, HMRC can go back six tax years to recover the underpaid income tax due and levy a financial penalty. HMRC will also charge interest on the underpaid and overdue income tax.
- The employer may have recovered too much in the way of employee contributions from the employee. As noted above, they may have collected 100 per cent of the employee contribution by incorrectly applying a net pay arrangement, rather than collecting 80 per cent in accordance with a relief at source arrangement.
- The pension fund may have recovered too much basic rate tax relief from HMRC. This would need to be refunded to HMRC and there is then an effect on the employees' pension funds as the tax relief (and any overpaid contributions where that applies) plus the return on that investment should (hopefully) have increased the value of their pension funds.
- The pension scheme could be underfunded, and investment returns may have been lost.

Example

An employer has a workplace pension scheme set up to operate ‘relief at source’ tax relief. Employee contributions are 5 per cent of pay. Shortly before the 2023/24 tax year, the employer changes payroll provider and the workplace pension scheme is for payroll purposes inadvertently set up to operate as a net pay arrangement, and 100% (rather than 80%) of the employee pension contributions are deducted.

The impact on a higher rate employee earning £6,000 a month is as follows for the 2023/24 tax year (this does not cover any tax relief that the employee may or may have not claimed personally through their tax return from HMRC):

	Monthly	Annual
Employee contribution deducted	£300.00	£3,600.00
Employee contribution that should have been deducted	£240.00	£2,880.00
Employee contributions over-deducted by employer	£60.00	£720.00
Tax relief claimed (See N1)	£195.00	£2,340.00
Tax relief which should have been claimed (see N2)	£60.00	£720.00
Tax relief overclaimed	£135.00	£1,620.00

N1	Monthly tax relief incorrectly given via payroll	£120.00	£300 x 40%
	Monthly tax relief claimed by pension scheme	£75.00	(£300 x 100/80)*20%
		£195.00	
N2	Monthly tax relief via payroll	£0.00	
	Monthly tax relief which should have been claimed by pension scheme	£60.00	(£240 x 100/80)*20%
		£60.00	

The amount of tax relief overclaimed of £1,620 is for one tax year for one employee. When taken across a workforce and over several tax years, the amounts overclaimed and the settlement with HMRC can be substantial.

What about salary sacrifice for pensions?

Salary sacrifice (or salary exchange) for pensions is an arrangement whereby an employee agrees to a reduction in their contractual gross earnings (by an amount equal to their employee pension contributions) or bonus payments. In exchange, the employer agrees to pay increased employer pension contributions instead.

Where implemented correctly salary sacrifice for pensions results in the employer and the employee paying less Class 1 National Insurance Contributions (NIC). This is because the employee gives up their right to receive salary (which would otherwise be liable to Class 1 NIC) and instead receives an employer contribution to a registered pension scheme (which is not liable to Class 1 NIC).

Salary sacrifice for pensions can potentially be used as an alternative, more NIC-effective way of operating a workplace pension scheme, regardless of whether the pension scheme is set up to operate ‘net pay’ or ‘relief at source’ tax relief on employee contributions (although the type of tax relief on employee contributions may influence the communication strategy used by the employer when the arrangement is implemented, and the groups of employees who can participate).

Care should of course be taken when considering salary sacrifice, including for certain groups of employees. For example, if employees are low earners and do not pay tax, they will still get a 20% top up into their pension if they are in a relief at source scheme. However, if their employer offers salary sacrifice arrangement, the employee participants will effectively lose the 20% top up into their pension pot, so could find themselves worse off. Not to mention other considerations such as the impact on National Minimum Wage or National Living Wage or any annual or lifetime pension limits.

We recommend that all employers who are not operating salary sacrifice in respect of their workplace pension scheme consider this option, especially given rising employment costs and the NIC savings that can be achieved. But this should be considered carefully though, taking into account all the pros and cons.

It should be noted that under salary sacrifice there can still be misunderstandings and mistakes regarding tax relief. If the employer operates salary sacrifice for pensions, then, for employees participating in that arrangement, the contributions into the scheme will be employer pension contributions. If the employer or payroll provider incorrectly informs the pension scheme that all or some of the pension contributions for participating employees are employee pension contributions, the pension scheme may start to claim tax relief on those contributions from HMRC when no such tax relief should be claimed. In these circumstances the tax relief claimed incorrectly would need to be repaid to HMRC, but some pension schemes will not do this until such time that the employer has disclosed the issue to HMRC and obtained HMRC's agreement to do that.

What should employers do?

Employers should check what type of tax relief their workplace pension scheme is set up to operate on employee contributions and make sure that it is being operated correctly. We would suggest going to the initial pension documentation, failing that asking the pension scheme to confirm and then undertaking payroll checks to see if it has been correctly set up, such as a gross to net calculation on sample pay periods/employees. Such checks would be advisable on the change or provider or at least each year to check any changes to the payroll set up.

In particular, employers with workplace pension schemes set up to apply 'relief at source' tax relief should check that employee contributions are not being collected from employees' gross pay and reducing their taxable pay for PAYE purposes

They should also review the reports going to the pension provider to make sure they use the right terminology, are clear and if they are referring to employee or employer contributions or both.

Employers who are not using salary sacrifice for pensions should consider whether it would be more beneficial to implement this. Employers already using salary sacrifice for pensions should ensure that it is set up and operating correctly to avoid unexpected liabilities and overclaimed tax relief.

Where issues are identified early action is necessary as the amounts at stake can quickly mount up. HMRC should be notified along with the Pensions Regulator and pension provider and discussions held to formulate a plan to rectify the issues. Different steps may be required depending on the exact nature of the error.

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Salary Sacrifice - Practical considerations

David Chandler discusses the attractiveness of salary sacrifice and the importance of compliant arrangements

The concept of salary sacrifice has been around for years, in the past used for a wide variety of benefits, like pension contributions, cycles to work, childcare, etc. Some "pushed the envelope" of what could be included including things like work car parking, bus passes, health screenings, gym memberships and even white goods and electronic gadgets. However, following the introduction of the rules around Optional Remuneration Arrangements, back in 2017, the Government changed the rules and the tax and/or NIC advantages behind salary sacrifice were reduced to only a few benefits. Following the end of all the grandfathering provisions now the only benefits that have an advantage from a tax/ NIC perspective are as follows:

- Pension contributions
- Pension related advice
- Tax exempt childcare (including qualifying nursery provision and childcare vouchers)
- Cycle-to-Work schemes
- Ultra-low emission vehicles ("ULEVs", those cars with CO2 emissions ≤ 75 g/kms)

Whilst the first 4 on the list above have been around for many years, salary sacrifice for electric vehicles is a relatively newer proposition. Salary sacrifice for cars has always been possible, although the tax/ NIC advantage was obviously only for lower CO2 emitting cars (as they had a lower tax charge). However, with the current very low tax rates on company cars (2% of list price for a fully electric vehicle (EV) through to April 2025), salary sacrifice into EVs is very attractive. However, salary sacrifice into an EV does bring a new challenge to the operational side of salary sacrifice. Companies who may previously only ever operated salary sacrifice for a pension scheme, or who have never undertaken salary sacrifice are now considering it. This article serves as a reminder of the rules around salary sacrifice and a look at some of the practical operations required when operating salary sacrifice, in particular for EV cars.

Anything not on the list above, is, in simple terms, generally subject to tax/NIC on the amount of the salary sacrificed, if greater than the taxable value of the benefit provided, thereby meaning no tax/NIC advantage to the employee or the employer.

What is salary sacrifice?

To recap, salary sacrifice is an agreement between an employer and employee to reduce an employee's pre-tax salary in return for receiving a non-cash benefit. As the gross salary is reduced, there are savings on tax and National Insurance Contributions for the employee. Employers also benefit through paying less Secondary Class 1 National Insurance Contributions on the gross amount sacrificed.

HMRC approach to Salary Sacrifice

As salary sacrifice has been used by companies for years, HMRC confirmed in a Tax Bulletin in April 2021 that they will no longer provide clearance for the operation of salary sacrifice, should employers request it (as, in their words, there is no material uncertainty).

In addition, they have provided huge amounts of technical guidance that employers can use in order to ensure their schemes are robust and valid. In terms of the guidance provided by HRMC, the following lists the more pertinent and common challenges that we see faced by employers.

Effective Salary Sacrifice

In order for a salary sacrifice to be effective, 2 conditions must be met:

1. The employment contract must be effectively varied **before** the changes are implemented. Therefore any right to receive salary/ cash must be given up **before** the employee is entitled to receive the renumeration (you can't sacrifice something you've already received).
2. The true construction of the revised contractual arrangement between employer and employee must be that the employee is entitled to lower cash remuneration and the new benefit.

Change to terms and conditions

The terms of the sacrifice must be formally set out in an amendment to an employee's contract of employment. The guidance states that the terms must be clear and outline the financial commitment made by employee and the rights of both employee and employer.

How to vary the contract

Varying the contract can be achieved in a number of ways:

- rewriting the contract in part or whole
- setting out agreed changes in a separate document (a letter or set paragraph)
- informing employees of proposals (see below)

The last bullet point covers what employers call "opt-in" processes. These are acceptable ways to approach variations, however there are some additional conditions required for the sacrifice to be valid, as follows:

- the employees have been fully informed of the proposals,
- they are given a specified date by which time an employee must "opt out",
- they continue working after this opt out date provided in the communication, and
- they continue working after the first pay-day when the changes have been implemented.

Valid Salary Sacrifice

If the employee has the right to give up the benefit *at any time* and revert to their higher cash salary then potentially the sacrifice may not be valid. The *Heaton* v *Bell* (46TC211) case established the concept of *money's worth*, which covers when an employee is able to give up a benefit at any given time resulting in their wage increasing. In *Heaton* v *Bell*, an employee was provided with a use of a car by their employer, and an agreed sum was deducted from their wages. However, as the employee could surrender the right to use the car at any time, this benefit counted as earnings under Section 62 ITEPA 2003 as it was considered money's worth. Money's worth includes things that are capable of being converted into money, or something of direct monetary value to the employee.

The application of this to salary sacrifice essentially means that if an employee can swap in and out of their sacrifice easily and frequently, HMRC would claim that salary sacrifice would be considered money's worth, and therefore subject to tax/ NIC in full as earnings.

What this means is that the sacrifice itself must be of a duration long enough for HMRC to be comfortable. Generally, sacrifice arrangements tend to be in place for at least 12 months, unless the employee experiences a lifestyle event (covered below) and HMRC have accepted this.

Lifestyle Events

There are cases where employee's financial circumstances can be changed due to a lifestyle event occurring, in which case HMRC would allow employees to opt in or out of the sacrifice arrangement. These may include:

- Changes to circumstances directly arising as a result of COVID.
- Marriage.
- Divorce.
- Partner becoming redundant or pregnant.

When considering altering a salary sacrifice arrangement for an employee, it is important that the appropriate consideration is given to the employment contract. The contract must change first and clearly set out the new entitlement to cash salary and non-cash benefit at any given time.

Payslips

Whilst there is no definitive requirement to change the payroll design, HMRC have in any event accepted that payroll providers have limitations on their systems. Therefore, where the employment contract has been effectively varied the format of the payslip will not be used to challenge the effectiveness of the arrangement. However, if the contract may not have been effectively varied, the format of the payslip is one piece of evidence HMRC would use in forming a view as to whether the sacrifice was valid or not.

National Minimum Wage

A salary sacrifice arrangement cannot reduce an employee's cash earnings below the National Minimum Wage (NMW) rates. Employers must put procedures in place to ensure NMW rates are maintained. This means that all salary sacrifice elements being provided must be taken into account (eg pension, EV cars, bikes to work etc).

Employers must have processes in place to identify if an employee can or cannot take part in a salary sacrifice scheme without going below NMW. This is especially key with those larger salary sacrifice benefits such as EV cars.

In addition, employees pay must be monitored regularly to ensure any future changes, such as NMW increases, do not take employees under any new rates. The current rate and upcoming NMW rates are as follows:

	23 and over	21 to 22	18 to 20	Under 18	Apprentice
April 2022 (current rate)	£9.50	£9.18	£6.83	£4.81	£4.81
April 2023	£10.42	£10.18	£7.49	£5.28	£5.28

What company cars are allowed?

Government policy is to encourage the take up of low emission cars as part of their overall aim at reducing CO_2. The OpRA rules allowed company cars emitting 75g/km or less to be included within salary sacrifice. However, care does need to be taken by employers as the amounts involved are often large (obviously therefore associated tax and NIC savings can also be large).

The 75g/km limit means the car could be a Plug in Hybrid Electric Vehicle (PHEV) and whilst the PHEV tax rates are still very low, they are much higher than pure electric cars only.

Typically a sacrifice for an EV/ PHEV will be taken for a period of between 24 and 48 months, and the employee will determine their own contract mileage based on their own circumstances.

The employer, when setting the amount of the gross sacrifice, will want to ensure that the amount reduced from pay covers all of their expected and potential costs. This will include the cost of the vehicle (usually leased) and appropriate insurances (car, early termination etc). If costs do arise outside of the sacrifice, eg an insurance excess, employers will often make it clear to employees that this will be a deduction from their net pay.

The other big issue employers will want to be sure of is the associated admin costs of running a scheme, as these have the potential to be significant. Many companies have spent the last ten years divesting themselves of company car schemes so may push back on reintroducing one.

Non-valid salary sacrifice schemes

If a salary sacrifice scheme is found to be not valid, through the contract not being effectively varied, or the opt in conditions were not met, then ultimately the employee remains entitled to the elements of the remuneration package previously specified. Therefore any tax/NIC would be due on the higher salary, rather than the reduced salary.

Summary

What is clear is that salary sacrifice for the right benefit can still be very attractive, both to employees, and employers, particularly so for EVs. However, it is paramount to make sure any salary sacrifice is valid and that the scheme remains compliant at all times, including the important national minimum wage implications.

David Chandler

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Directors – Tax and National Insurance, the challenges…

Paul Tucker discusses the tax and National Insurance issues arising from engaging a director

Unlike employees, directors of a company are usually easily identifiable by a quick check at Companies House (and there is no charge for the search!). This information is available to everybody, including HMRC.

In the event of an HMRC enquiry, they will look closely at how a company's directors have been dealt with for tax and National Insurance (NI).

There are many issues to consider, but three of the most common areas where errors occur are in relation to:

1. The engagement of directors;
2. Directors' expenses; and
3. Directors' NI.

I will look at these three issues in detail in this article. There are also challenges in respect of non-UK resident directors, but in this article I am focusing on UK resident directors only.

Engagement of directors

Nearly all directors should be paid through the payroll and subjected to tax and NI as they are officeholders (subject to the two exceptions I have highlighted later in this article).

HMRC have identified directors as a Particular Occupation in their Employment Status Manual and have set out their view of the tax and NI treatment at ESM4040.

- Paragraph one of ESM4040 states:
  "*A company director holds an office.*"

- It then continues:
  "*Any emoluments/earnings arising from a directorship are therefore chargeable under Schedule E/as employment income and subject to Class 1 NICs.*"
  https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm4040

What is an office for the purposes of the definition of officeholder?

Office is not defined in any legislation. However, for tax purposes HMRC uses the definition set out in the cases of *Great Western Railway Company* v *Baxter* 8TC231 and *Edwards* v *Clinch* 56TC367 (https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm2502 and https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm7080).

In the Great Western Railway case it was held that an office is "*a subsisting, permanent, substantive position which had an existence independent from the person who filled it, which went on and was filled in succession by successive holders.*"

In the Edwards case, it was held that the "*rigid requirement of permanence was no longer appropriate, and continuity need not be regarded as an absolute qualification.*"

Shadow directors

The question of shadow directors is particularly tricky and appears to be subject to a conflicting opinion at HMRC.

Their National Minimum Wage Manual expresses the view that a shadow director is not an officeholder. In their guidance NMWM05150 they state that "*any payments received from the company are likely to be paid under a contract of some kind, either a contract of employment or a contract to perform services personally*". Their view is a shadow director is likely to be a worker under the National Minimum Wage Act 1998. (https://www.gov.uk/hmrc-internal-manuals/national-minimum-wage-manual/nmwm05150)

That contrasts with their Employment Income Manual EIM20200 where they express the view that the term director includes shadow director! (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim20200)

Directors who are not paid via the company payroll

Any statutory director who is not paid via the company payroll will be easily identified by HMRC, as they will appear on the Companies House Register, but will **not** be on any RTI PAYE submissions. That will lead to the question from HMRC, how are they paid?

The answer is likely to be either:

- They are self-employed;
- They provide their services via their own Personal Service Company (PSC); or
- They are not resident in the UK.

As noted in the introduction above, this article is focusing on UK resident directors only. However, if a UK company has a non-resident director, who is not included on their payroll they should look at the position very carefully and be able to explain to HMRC why they are not.

Any claim that the director is self-employed either directly or via their PSC will usually be rejected by HMRC, unless they can also successfully demonstrate a separate and distinct role within the business, which is set out in more detail below.

Engagers need to be able to demonstrate to HMRC's satisfaction that PAYE (tax and NI) is not due from any off-payroll payments they have made. That includes payments made to directors (whether executive directors or non-executive directors ("NEDs")).

One of the first questions on HMRC's Check Employment Status for Tax (CEST) tool is "*Will the worker be an "Office Holder"?*". If the answer is yes, then no further questions are posed and the status is determined as "*Employed for tax purposes for this work*".

The differing treatment of executive directors and NEDs

An officeholder is typically either an executive director or a non-executive director. Executive directors perform a multitude of duties as part of their role. A NED is more likely appointed to attend Board meetings (their director duties) and potentially provide specialist consultancy services as well.

A NED will always be an officeholder in relation to their director duties, but it is possible, depending on the facts that they may be self-employed in respect of the amounts paid for consultancy services. As a result, some payments will be processed through the payroll and others via invoice with no tax or NI deduction. HMRC would expect to see a contract for each service, as well as a demonstration that the "other services" are performed on a self-employed basis. HMRC are unlikely to accept a similar approach for an Executive Director as their service agreement is likely to be wide ranging and cover all the duties they undertake (it will be difficult to demonstrate when the role of an executive director stops and the other services are provided).

What about engagements via PSCs?

It could potentially be argued that an engagement via a PSC is the engagement of the PSC and not an individual. However, this often conflicts with both Companies House information and the contract between the engager and the director, which is usually based on the individual's personal engagement.

HMRC's starting point is that the engagement between the engager and director is a personal appointment and therefore the engaging entity has a responsibility to account for PAYE on payments made for that individual's services.

An alternative argument that engagers sometimes put forward is that the PSC is providing two services (director services and other services, most typically consultancy). As noted above, HMRC are unlikely to accept the argument for an Executive Director, but may do for a NED (with the NED duties still being subject to PAYE and the fees for the other services being taxed in the PSC).

Even if HMRC do not pursue the engaging entity for any PAYE, they could still pursue the PSC under the IR35 legislation and its interaction with officeholders, as highlighted in HMRC's Employment Status Manual ESM 8395. (https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm8395)

The exceptions

As mentioned above, there are a couple of exceptions to the general rule that all directors should be paid through the payroll, they are in respect of:

- Nominee directors; and
- Directors who are members of professional partnerships.

The exceptions are similar, in that both involve the directors' fees going to either another company or a partnership rather than the director.

The rules are complex and the interaction with ITTOIA (for income tax purposes) and CTA 2009 (for corporation tax purposes) also needs to be considered. There are many conditions to satisfy, including one that prevents the exceptions applying for PSCs (section 16B(6) of ITTOIA and section 40A(6) of CTA 2009).

- **Nominee directors**

  In the case of a Nominee Director, HMRC's guidance ESM4240 confirms that:

  "*Where a director of Company A is appointed to the Board of Company B as a nominee of Company A, and hands over their fees from Company B to Company A, those fees may be assessed on Company A rather than on the director.*"

  NB. This guidance continues to refer to Extra Statutory Concession A37 when the Enactment of Extra-Statutory Concessions Order 2018 enacted this concession and its associated conditions, with effect from 6 April 2018, by amending section 6(5) of Income Tax (Earnings and Pensions) Act 2003 (ITEPA) and introducing section 16B of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA) and section 40A of the Corporation Tax Act 2009 (CTA 2009).

HMRC go on to confirm the legislated conditions to be met in their Employment Income Manual EIM2505 and they state:

"The treatment can apply where:

- *A company (the paying company) makes a payment to, or for the benefit of, a director in respect of the director's employment as a director of that company;*
- *The payment would otherwise be employment income of the director chargeable to tax under Part 2 of ITEPA; and*
- *The director was appointed by a company (the appointing company) other than the paying company."*

If those conditions are met, then two more conditions must be met:

- the profits of the appointing company are within the charge to Income Tax [or corporation tax]; and
- by virtue of an agreement with the appointing company the director is required to account for the payment of the director's fees to that company.

If met then one of two further conditions regarding the appointing company must also be met:

- Condition A is that the appointing company had the right to appoint the director by virtue of its shareholding in, or agreement with, the paying company; or
- Condition B (where Condition A does not apply) is that the appointing company is not one over which the director or any person connected with the director, either singly or jointly, has control. The persons who are connected with the director are the spouse, civil partner, parent, child, son-in-law or daughter-in-law of the director.

(Section 6(5) ITEPA 2003, Section 16B ITTOIA 2005, Section 40A CTA 2009, https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm4240, https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim02504, and https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim02505)

- **Directors who are members of professional partnerships**

HMRC 's guidance at EIM02501 sets out the conditions that must be met:

- The treatment can apply where a company makes a payment to or for the benefit of a director in respect of the director's employment as a director of that company; and
- The payment would otherwise be employment income of the director; and
- The director was or is a member of a partnership.

If all of those conditions are met, then all of the following must also be met for the exception to apply:

- The director carries on a profession; and
- Being a director of a company is a normal incident of that profession and of membership of the firm; and
- The director is required by the terms of the partnership agreement to account to the firm for the payment; and
- The amount of the payment is insubstantial, compared with the total amount brought into account as receipts when calculating the firm's profits.

It should be noted, partnerships that wish to include the directors' fees received in their gross partnership income (whether or not the directorship is held in the year of assessment or whether or not the partner concerned is still a partner) are expected to provide HMRC with a written undertaking to that effect. (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim02500, and https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim02501)

Directors' expenses

In the event of a review by HMRC the directors' expenses would usually come under close scrutiny. Expenditure such as entertaining (business and staff) and staff gifts may well be incurred by the directors of a company, possibly on their credit cards. HMRC will closely scrutinize those directors' expenses if they undertake a review. It is vital that as much information as possible is maintained in respect of expenses incurred by directors to demonstrate to HMRC that they have been treated correctly for tax and NI purposes.

In addition, HMRC will, as with any employee, look at any costs that relate to travel to a directors' permanent workplace and also any accommodation provided at or near that workplace as those costs will be taxable and liable to NI.

NED travel and subsistence will be of particular interest. There is very little commentary or guidance in respect of NEDs and their expenses, other than HMRC's Booklet 490. Paragraph 3.12 provides a useful example which confirms HMRC's view that if all or almost all of the time a NED spends working for that employer is at a single workplace it will be treated as their permanent workplace and any reimbursement of travel costs between home and that workplace will be taxable and liable to NI and no tax relief will be available. (https://www.gov.uk/guidance/ordinary-commuting-and-private-travel-490-chapter-3#non-executive-directors)

Directors' National Insurance

National Insurance is usually calculated on a non-cumulative basis. As directors have the ability to pay themselves as much as they wish when they wish there would, without special rules, be the opportunity to structure the payments to avoid NI.

Who is a director for NI purposes?

Before considering the special rules, employers need to identify who are their directors for NI purposes. Regulation 1(2) Social Security (Contributions) Regulations 2001 confirms that a director for NI purposes means:

- In relation to a company whose affairs are managed by a board of directors or similar body, a member of that board or similar body; and
- In relation to a company whose affairs are managed by a single director or similar person, that director or person; and
- Any person in accordance with whose directions or instructions the company's directors as defined above are accustomed to act; for this purpose a person is not treated as such a person by reason only that the directors act on advice given by that person in their professional capacity.

As highlighted in the first part of this article, HMRC's view is that a shadow director is a director for tax purposes. It would appear that they should also be a director for NI purposes under the final bullet above.

Annual Earnings Period basis

Regulation 8 Social Security (Contributions) Regulations 2001 defines the earnings periods for calculating directors NI. HMRC's National Insurance Manual NIM12021 confirms that a director has an annual earnings period (unlike employees who typically have weekly or monthly earnings periods).
(https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim12021)
This means their NI is calculated on a cumulative basis with annual limits applied from the start of the tax year (subject to the note below in respect of appointments during a tax year).

Alternative approach

There is an alternative, briefly set out in NIM12026 whereby the company may treat the director in the same way as other employees, **but**, must use the annual or pro-rata earnings period at the end of the tax year to calculate the correct amount of Class 1 contributions that are due (or if the director ceases to be a director before the end of the tax year in question, their last payment of that year). NB. This end of year 'recalculation' results in the same NI being payable as under the Annual Earnings Period basis but the timing of NI contributions throughout the year can be very different (see examples below). (https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim12026)

Appointments and ceasing to be a director during a tax year

The annual earnings period is pro-rated in respect of appointments during a tax year, but it is not pro-rated when a director ceases during a tax year.
(https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim12022)
However, if a director ceases to be a director and becomes an employee of the same company then NI on earnings continues to be calculated for the rest of the tax year using an annual earnings period.
(https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim12024)

Directorship ceases and earnings paid in a subsequent tax year

HMRC's National Insurance Manual NIM12025 confirms that the earnings period is the year in which the earnings are paid if they are paid in a tax year after the directorship ceased and they can be linked to any period during which the directorship was held.
(https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim12025)

They provide an example of a director who ceases their directorship in the 2020/21 tax year, remaining with the company as an employee and in July 2021 receiving:

- Fees which relate to the period of directorship in the 2020/21 tax year; and
- Their normal salary as an employee.

They confirm that NI should be calculated:

- On the fees by reference to an annual earnings period (2021/22); and
- On the salary by reference to the normal monthly earnings period.

Danger areas

There are many danger areas including:

- The impact of 2022/23 multiple NI rates (which for simplicity, I have not covered here as hopefully that was a one off and will not occur again!);
- Not flagging a director to be considered for the annual earnings period or alternative approach;
- Leaving a director on the employee NI calculations and not undertaking the reconciliation as required under the alternative approach;
- Not pro-rating the limits when a director is appointed part way through a tax year; and
- Not applying the correct NI treatment where a directorship ceases and earnings are paid in a subsequent tax year.

Examples

As well as HMRC's National Insurance manual, useful guidance is contained in HMRC's booklet CA44.

Given the complexities of multiple NI changes in 2022/23 the following examples are for the 2023/24 tax year.

Director in post for the full tax year, paid £3,000 per month and a bonus of £50,000 in April 2023.

Month	Annual Earnings Period		Alternative Approach	
	Employees NI	Employers NI	Employees NI	Employers NI
April 2023	£4,578.60	£6,058.20	£1353.14	£7,209.39
May 2023	£60	£414	£234.24	£309.36
June 2023	£60	£414	£234.24	£309.36
July 2023	£60	£414	£234.24	£309.36
August 2023	£60	£414	£234.24	£309.36
September 2023	£60	£414	£234.24	£309.36
October 2023	£60	£414	£234.24	£309.36
November 2023	£60	£414	£234.24	£309.36
December 2023	£60	£414	£234.24	£309.36
January 2024	£60	£414	£234.24	£309.36
February 2024	£60	£414	£234.24	£309.36
March 2024	£60	£414	£1,543.06	£309.21
Total	£5,238.60	£10,612.20	£5,238.60	£10,612.20

This example demonstrates the difference in NI payable each month using the two methods of calculation. In this example, the March 2024 Alternative Approach figure for employees NI also illustrates the recalculation required at the end of the year when the Alternative Approach is used.

Director in post for the full tax year, paid £5,000 per month and a bonus of £10,000 in March 2024.

Month	Annual Earnings Period		Alternative Approach	
	Employees NI	Employers NI	Employees NI	Employers NI
April 2023	£0	£0	£393.14	£585.40
May 2023	£0	£124.20	£393.14	£585.40
June 2023	£291.60	£690	£393.14	£585.40
July 2023	£600	£690	£393.14	£585.40
August 2023	£600	£690	£393.14	£585.40
September 2023	£600	£690	£393.14	£585.40
October 2023	£600	£690	£393.14	£585.40
November 2023	£600	£690	£393.14	£585.40
December 2023	£600	£690	£393.14	£585.40
January 2024	£600	£690	£393.14	£585.40
February 2024	£600	£690	£393.14	£585.40
March 2024	£300	£2,070	£594.06	£1,964.80
Total	£4,918.60	£8,404.20	£4,918.60	£8,404.20

This example shows the position where a director is in post for a full tax year and is paid over the Primary Threshold each month. And, again, the March 2024 employees NI figure under the Alternative Approach illustrates the required end of year recalculation.

Take away points

Advisers and employers should identify:

1. All directors registered at Companies House;
2. Those directors who are not paid through the payroll and take any corrective action;
3. Expenses incurred by directors to ensure the correct tax and NI treatment has been applied (not forgetting NED expenses);
4. Any directors who are not subjected to the special directors' Annual Earnings Period NI rules and reconcile their NI to ensure there are no underpayments;
5. Any potential shadow directors and consider how they should be dealt with for tax and NI.

Paul Tucker

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Group Income Protection: The Contribution Conundrum

Sarah Hewson provides an overview of the treatment of Group Income Protection premiums and payments and the impact of the Optional Remuneration Arrangement rules following updated HMRC guidance

Group Income Protection (**"GIP"**) policies are insurance policies designed to provide employees with a regular income if they cannot work because of long-term sickness or injury. How any premiums and any subsequent payments made under the policy are treated from an employment tax perspective depends on a number of factors, particularly whether the premiums are deemed to be employer or employee funded.

Employer Funded Premiums

An increasing number of employers are entering into GIP policies to insure against the risk of having to continue to pay salaries to employees on long-term leave due to sickness or disability. This section outlines the employment tax treatment where an employer bears the full cost of the premium.

Treatment of premiums

The mere presence of a GIP set up to make payments where an employee is absent because of sickness or disability is not itself a taxable benefit (Section 202(1)(c) of the Income Tax (Earnings and Pensions) Act 2003 (**"ITEPA"**)). Broadly speaking, this is the case in respect of arrangements made by the employer with an insurance company or some other third-party fund where the employer insures its own risk rather than intending to confer a benefit for employees. In this scenario, HMRC confirms the right to receive sick pay, or the prospect of receiving it, is not a benefit chargeable on directors and employees (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim21820).

Treatment of payments

Where any payments made under the policy are made to an employer for onward distribution to the relevant employee, any sick pay received by an employee is considered to be general earnings and is therefore subject to income tax (under Section 62 of ITEPA) and Class 1 (employer and employee) National Insurance (**"NI"**) (under Section 4(1)(b) of the Social Security Contributions and Benefits Act 1992 (**"SSCBA"**)) via the payroll.

To the extent that the insurer pays any amounts directly to the employee (or a member of their family), any amounts received by the employee are still considered earnings and should therefore still be processed via the payroll for income tax (under Section 221(3) of ITEPA) and Class 1 (employer and employee) NI (under Section 4(1)(b) of the SSCBA) purposes.

Employee Funded Premiums

Some employers require employees to bear the cost of any GIP premiums and often it is agreed between the employer and the employee that the employer will deduct the cost of the premium from the employee's net (ie post tax and NI) pay. This section outlines the employment tax treatment where an employee bears the entire cost of the premium from their net pay (note that the impact of a salary sacrifice arrangement is addressed below).

Treatment of premiums

Assuming the policy is arranged by an employer to protect its own risk, the treatment outlined above is also broadly applicable in this scenario - there may be some nuances where a policy is allocated to an employee. However, on the basis employees have fully borne the cost of the relevant premiums out of post-tax pay, any benefit will be deemed to have been fully made good in any case.

Treatment of payments

For this purpose, HMRC accepts that any amount an employer recovers from the employee is to be treated as payment of an appropriate part of the premium by the employee, provided it is recovered from their income after tax (https://www.gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm6120).

On this basis, to the extent the full cost of the premium is recovered from an employee's post tax pay (eg via a net pay deduction), any payments made to employees (or a member of their family) under the relevant GIP policy are not taxable as employment income (Section 325A of ITEPA and https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06420; albeit a personal tax obligation may arise for the individual subject to the conditions for an exemption under Section 735 of the Income Tax (Trading and Other Income) Act 2005 being met). In the same vein, any payment from the GIP attributable to contributions made by the employee is not subject to NI (under Section 4(2) of the SSCBA and Paragraph 7 of Part X of Schedule 3 of the Social Security (Contributions) Regulations 2001 (**"SSCR"**) and confirmed in https://www.gov.uk/hmrc-internal-manuals/national-insurance-manual/nim02345).

To the extent the insurer pays the amounts directly to the employee (or a member of their family), the tax and NI position remains unchanged (ie this can be paid free of any income tax and/or NI withholding).

Mixed Employer and Employee Funded Premiums

Complexities may arise where an employer and employee jointly fund any relevant GIP premiums, eg only part of the premium is funded out of an employee's net pay.

Treatment of premiums

Assuming the policy is arranged by an employer to protect its own risk, the treatment outlined above is also applicable in this scenario, ie neither an income tax, NI nor reporting obligation arises in relation to either the employer or employee element of the premium.

Treatment of payments

Where an employer arranges a GIP into which the employer and employee are both deemed to contribute, any payments made to employees (or a member of their family) are not treated as earnings to the extent that the amount received reflects contributions made by the employee (under Section 221 of ITEPA). As such, the amount attributable to the employee's contributions needs to be ascertained; for tax purposes any such apportionment must be made on a just and reasonable basis (Under section 221(4) of ITEPA and Paragraph 7 of Part X of Schedule 3 of the SSCR).

For example, if the annual cost of the premium is £600, £200 of which is recovered from the employee's net pay, two thirds (£400/£600) of any payment would be subject to income tax and Class 1 (employer and employee) NI via the payroll. The remainder of the payment can be made free of any income tax or NI withholding (https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06430).

To the extent the insurer pays any amounts directly to the employee (or a member of their family), any amounts received by the employee (or family member) attributable to contributions made by the employer would still be considered earnings and should therefore be processed via the payroll for income tax and Class 1 (employer and employee) NI purposes (under Section 221(3) of ITEPA and Paragraph 7 of Part X of Schedule 3 of the SSCR).

Optional Remuneration Arrangement Rules

Changes restricting the income tax and NI advantages in relation to benefits provided as part of an Optional Remuneration Arrangement (**"OpRA"**), (ie either under a salary sacrifice ('Type A') or any other arrangement whereby a benefit can be exchanged for cash ('Type B')) were introduced with effect from 6 April 2017 (Sections 69A and 69B of ITEPA).

The OpRA provisions seek to tax the higher of the value of the benefit as calculated under tax rules where no OpRA was in place (the 'ordinary benefit value') and the salary given up / cash amount surrendered by an employee to receive it (the 'cash foregone').

As part of the introduction of the OpRA rules, the legislation was amended (Section 202(1A) of ITEPA was introduced) to make it clear that, where provided under an OpRA, the GIP premium would fall to be a taxable benefit. Where a benefit would otherwise be exempt but for the OpRA rules, HMRC considers that the 'cost' of the benefit is nil so that the value of the benefit is the cash foregone by the employee.

Impact on the treatment of premiums

The impact of the OpRA rules on the value of any benefit to be reported in relation to the premiums will largely depend on the specific structure put in place by the employer, eg whether employees are able to flex the level of cover. However, where the full amount of the premium is funded by a salary sacrifice arrangement, this will be fully caught by the OpRA rules. In this case, the value of the cash foregone (ie the salary sacrificed) by the employee will be a taxable benefit and must be reported on Form P11D for tax purposes (or processed via the payroll for tax purposes where the employer has registered to payroll the GIP benefit) and Form P11D(b) for Class 1A (employer only) NI purposes.

Impact on the treatment of payments

Whilst the precise position will depend on the specific structure put in place by the employer, where the full amount of the premium is funded by a salary sacrifice arrangement, the full amount of any payment(s) must be subject to income tax and Class 1 (employer and employee) NI via the payroll, whether paid by the employer or directly by an insurer.

This is on the basis that, whilst the economic cost of the GIP premium is ultimately borne by the employee through the salary sacrifice arrangement, (assuming the sacrifice is effective for income tax and NI purposes) the cost of the premium is funded out of an employee's pre (rather than post) tax pay. Therefore, when any payment under the GIP is made, it strictly derives from an employer-paid premium, such that any payments to the employee (or a member of their family) are considered earnings for income tax and NI purposes and must therefore be processed via the payroll (whether paid by the employer or directly by an insurer).

This means that employees will in effect suffer double taxation under the employment tax provisions due to the OpRA rules, i.e. the employee will suffer tax on both the premium and any subsequent payments made under the GIP.

Whilst historically HMRC broadly accepted that premiums taxed as a benefit under the OpRA rules would count as employee contributions for the purposes of the broader income tax position (having outlined this in guidance to the Association of British Insurers on 15 October 2019 – referenced at link 8 below), HMRC has recently updated its guidance to make it clear that it no longer accepts this position on the basis the cost of the premium has not been borne out of an employee's post tax pay. The updated position is outlined in the below:

1. https://www.gov.uk/hmrc-internal-manuals/insurance-policyholder-taxation-manual/iptm6120;
2. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06410;
3. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06420;
4. 8https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06430;
5. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06460;
6. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06470;
7. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06471; and
8. https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim06474

Helpfully, HMRC has confirmed that it will not seek to revisit/challenge the tax treatment where employers had relied on its previous (now superseded) guidance that, where premiums had been paid by the employer, but the employee had been taxed on those premiums under the OpRA regime, then those premiums could be treated as if they had been paid by the employee when taxing the benefit payments. Such reliance is to be assumed unless any claim indicates there was no such reliance, and this can apply in respect of:

- sick payments made to employees or former employees without the deduction of tax between 15 October 2019 and 31 December 2023 (inclusive) to the extent that such payments are (or are derived from) amounts that can or have been attributed on any just and reasonable basis to salary foregone by employees in periods starting on or after 6 April 2017
- repayment claims (including overpayment relief claims and PAYE adjustments) made between 15 October 2019 and 1 December 2022 (inclusive) to the extent that these claims related to sick pay payments made to employees or former employees and are, or are derived from, amounts that can be attributed on any just or reasonable basis to salary foregone by employees in periods starting on or after 6 April 2017
- sick pay payments made on or after 1 January 2024 without the deduction of tax to the extent that they are made or are derived from amounts that can be attributed on any just or reasonable basis to salary foregone by employees between 15 October 2019 and 31 December 2023

Next Steps

Whilst some employers already process the full amount of any payment made under a GIP through the payroll for income tax and NI purposes for administrative ease (given the complexities often involved in calculating any apportionment where available) irrespective of whether or not they are provided under a salary sacrifice arrangement, employers who do not currently process the payment through the payroll need to:

- document their reliance on HMRC's previous guidance (where applicable);
- review how any payments made prior to 15 October 2019 were treated for income tax and/or NI purposes; and
- review and refresh processes in place to ensure that:
    - the employment tax treatment of any GIP payment is considered;
    - relevant payments (or the relevant portion thereof) are processed via the payroll for income tax and NI purposes from 1 January 2024 (or going forward where any claim indicates no reliance was placed on the earlier guidance, with a review of the historic position); and

- for completeness, where provided under a salary sacrifice arrangement, the relevant amount (ie the salary sacrificed) is correctly being reported via Form P11D (or the payroll where relevant) and Form P11D(b).

Sarah Hewson

Having previously practised as a tax lawyer at an international law firm, Sarah moved away from law to specialise in employment taxes and is currently the UK Employment Tax Technical Lead at Vialto Partners. As well as feeding into technical tax consultations and policies, Sarah utilises her broad range of skills to advise clients on key employment tax related issues. Sarah has an active role in the CIOT/ATT, sitting on CIOT Council and various committees, including the Employment Tax Technical Committee, as well as being Chair of Membership & Branches. Sarah can be contacted at sarah.hewson@vialto.com.

CIOT Employment Taxes Committee – Budget Representations

Matthew Brown summarises the Budget Representations made by the CIOT's Employment Taxes Committee

The CIOT's Employment Taxes Committee's recommendations (https://www.tax.org.uk/ref1079) included 34 suggestions for the upcoming Budget in respect of simplification of employment taxes and the pensions tax regime. Our suggestions fell into three categories, (i) the cost of living, (ii) employment taxes simplification, and (iii) simplifying the pensions tax regime.

The cost of living

We recommend reviewing all fixed allowances and flat rate deductions contained in the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003), and related legislation and guidance, with a view to uprating these figures in line with inflation and current market rates. We include specific examples of amounts that we believe need to be increased such as:

- Homeworker's additional household expenses, where we suggest uprating the rate and switching from a weekly to a capped daily rate,
- Authorised Mileage Allowance Payments (AMAPs), where we suggest both a review of the policy and introducing a new starter higher rate of reimbursement,
- Industry flat rate expenses deductions for tools and special clothing and laundry costs, where we suggest both an inflationary increase and reviewing how these amounts should be reviewed and uprated in the future,
- Benchmark rates for reimbursement of meals and subsistence, the trivial benefits exemption, annual parties and functions and the £150 limit, and the removal benefits and expenses exemption; in each case we suggest reviewing and uprating the amounts in line with inflation.

Simplifying the employment tax rules

We suggest a number of simplifications and easements to the benefits-in-kind and taxable expenses regime aimed at reducing administrative burdens for employers, employees and HMRC. In particular, we recommend removing the distinction between employer provided/employer paid and employer reimbursed expenses as the tax consequences should not depend on whether the employer directly incurs the cost or reimburses an expense the employee has incurred. We include specific examples of this issue such as the trivial benefits exemption, equipment provided to enable the employee to work from home, flu vaccinations (usually exempt under the trivial benefit rules if directly provided or provided by way of a voucher but not if employee reimbursed), and eye/eyesight tests and special corrective appliances (such as glasses) (where HMRC has recently updated its guidance to reflect the limitation of the current legislative exemption).

We also recommend a number of measures aimed at enabling employers to better support employees. These include reopening the childcare voucher scheme to new entrants to assist employees who do not qualify for the tax-free childcare scheme, providing a tax incentive for exempt work-related training for new employees such as the Over 50s or those returning from long-term ill-health/permitting employers to apply unused apprenticeship levy funds to training these employees, and introducing an exemption for financial coaching and money management advice.

In addition, we make recommendations aimed at reducing administrative burdens on employers and HMRC.

These include, (i) bringing in a specific deduction, at a flat rate, when an employer and employee agree that the employee can work from home, ie where the employer does not reimburse tax-free the employee's additional household expenses arising from working from home, (ii) removing the tax charge when equipment is retained by an employee on leaving the employment, as often the equipment is of little or no use to the employer, or at least taking into account the cost to the employer of recovering the item when valuing the benefit-in-kind under the transfer of assets provisions, and (iii) correcting HMRC's guidance on taxing reimbursements of home electricity costs when recharging a company electric vehicle (which we contend, contrary to the existing guidance, is not taxable) is not taxable.

Further recommendations are made for using artificial intelligence to automatically approve routine applications to HMRC where certain criteria are met. For example, Section 690 and similar PAYE directions, CIS small payment applications by deemed contractors, and PSA applications. Our view is that automating agreement of straightforward applications will allow HMRC to concentrate its (limited) resources on the more complicated and higher risk applications.

…and simplifying the pensions tax regime as well

Our final simplification recommendations concern the pensions tax regime, where we make some recommendations for removing undue complexity.

Our suggestions include rectifying anomalies in taxing lump sums from pension schemes, where we raise four separate issues which we think require legislative changes. We also suggest amending the legislation to treat ex-gratia payments by employers on the death of an employee by 'natural' causes in the same way as an equivalent payment on the 'accidental' death of an employee. Lastly, we suggest improving pension scheme administration by (i) fixing problems with Guaranteed Minimum Pension (GMP) sex equality equalisation conversions, noting that thousands of pension schemes are currently unable to pay pension scheme members the benefits they are due because their legal advisers are advising that the tax and pensions law is unclear where a pension scheme undertakes a 'GMP' conversion to equalise pension benefits, and (ii) fixing problems with scheme block transfers, so that, for example, schemes with both Defined Benefit (DB) and Defined Contribution (DC) entitlements can split the DB and DC rights where they want to consolidate the DC sections of their scheme into larger schemes such as master trusts.

Matthew Brown

Matthew Brown is the Technical Officer for the Employment Taxes Committee of the Chartered Institute of Taxation.

Consultations and Submissions

CIOT Employment Taxes Committee – Public submissions – February 2022 to February 2023

Draft legislation: The Social Security Contributions (Freeports) Regulations 2022	17 February 2022
Umbrella Company Market	22 February 2022
Construction Industry Scheme: Landlord contributions to tenant works (Joint submission with CIOT Property Taxes Committee)	3 May 2022
Helping savers understand their pension choices	25 July 2022
Low earners anomaly: pensions relief relating to net pay arrangements	28 September 2022
Review of hybrid and distance working	4 November 2022
COVID-19 Employment Support Schemes	25 November 2022
Budget Representation: Employment Taxes and Pensions Tax Regime	1 February 2023

Suggestions?

If you have any suggestions for further articles, please let us know: technical@ciot.org.uk

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Chartered Institute of Taxation.