



PAYROLLING OF EMPLOYEE BENEFITS AND EXPENSES

ICAEW welcomes the opportunity to comment on the consultation paper *Employee benefits and expenses: Real time collection of tax on benefits in kind and expenses through voluntary payrolling* published by H M Revenue & Customs on 18 June 2014.

This response of 10 September 2014 has been prepared on behalf of ICAEW by the Tax Faculty.

Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

Contents

	Paragraphs
Major points	
Introduction	1-3
Key point summary	4-6
General comments and some other points to consider	7-16
Responses to consultation questions	17-57
Ten Tenets for a Better Tax System	Appendix 1

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MAJOR POINTS

Introduction

1. We welcome the opportunity to comment on the proposals in HMRC's consultation document of 18 June 2014.
2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.
3. In 2007 and 2008 we participated in numerous meetings with HMRC on payrolling benefits-in-kind and expenses (in this document collectively described as BiK), and responded on 12 March 2008 in [TAXREP 25/08](#) to HMRC's [consultation document](#) published on 13 December 2007. More recently, in 2013 we gave evidence in meetings to the Office of Tax Simplification to help them compile their [interim report on employee BiK and expenses](#) published on 8 August 2013 and their [second report \(formerly called final report\) on employee BiK and expenses](#) published on 14 January 2014. Since then, OTS published on 18 July a note on HMRC's condox on employee BiK published in June 2014 (including this one) and on 31 July another [final report](#).

Key point summary

4. We welcome HMRC's pragmatic approach in the consultation document (condoc) to payrolling, especially when compared to when this topic was considered in 2007-08. We also welcome the statement in para 4.8 that a voluntary payrolling system should be simple to administer.
5. We recommend that:
 - payrolling of BiK should be optional for employers;
 - any employer should be able to payroll any BiK for any employee, as the employer chooses;
 - the tax and NIC charging rules on benefits-in-kind and expenses (BiK) should be reviewed to make them compatible with payrolling BiK;
 - the K code rule should be extended so that an employee's net pay is not reduced to less than 50% of gross because of tax and NIC deductions, in particular on one-off BiK;
 - there should be no obligation on employers separately to report to HMRC BiK which have been payrolled, eg on an end of year return such as form P11D or a spreadsheet;
 - employers should be obliged to detail each payrolled BiK individually on employees' payslips and end of year forms P60; the real time information (RTI) full payment submission (FPS) will need additional fields to enable the aforementioned information to be provided to employees and to HMRC for government statistical purposes.;
 - sufficient time needs to be given to software developers for a full consultation on the changes and for development;
 - employers should have the option to pay Class 1A NIC 'as they go' – but HMRC needs to improve its systems for refunding overpaid PAYE and NIC;
 - HMRC should improve its code number allocation systems so that code numbers are not only accurately and quickly changed but also are notified promptly to both employers/ payroll agents/ bureaux and employees when an FPS records that an employer has started payrolling BiK hitherto included in code numbers or when employees move between employers who payroll different BiK;
 - employers need to be allowed to make corrections without penalty implications, say within three months of the initial payrolling entry, and a means of 'trueing up' at the year end will need to be developed that enables employers to account for 'unders' and 'overs' easily, we envisage within the first three months of the new tax year either via the payroll or on form P11D as they choose (the extent to which corrections will be needed will depend on the extent to which tax and NIC charging rules are simplified to make them payrolling BiK-friendly);
 - processes need to be developed for employers of cross-border employees, expatriates coming into the UK who are not or cannot be included in a modified Appendix 6 scheme

and expatriates leaving the UK, etc which recognise the more complex administrative burden of dealing with the PAYE and BiK of such employees and enables them to be brought into a payrolling regime without undue burden; and

- regard be had to our *Ten Tenets for a Better Tax System* (summarised in Appendix 1), especially no.4: *Ease of collection*, when designing payrolling of BiK processes.

6. The statement in para 4.8 of the condoc that there are no plans to introduce the reform required for a 'right first time' model needs to be reconsidered, otherwise, without overarching changes to many of the BiK tax and NIC charging rules (as recommended along with other points, many of which are still relevant, in our earlier response [TAXREP 25/08](#) referred to above), payrolling will fail to:
 - ameliorate burdens on employers;
 - reduce HMRC processing time and calls to helplines or increase code number accuracy; or
 - provide meaningful data to enable universal credit to be accurately means tested.

General comments and some other points to consider

7. We welcome the fact that HMRC is, in the condoc, taking a far more pragmatic approach to how payrolling will operate than when this topic was considered in 2007-08, to the extent that meaningful consideration appears now to be being given to payrolling being voluntary, and not having to apply to all benefits-in-kind (BiK) and employees. However, even if payrolling is not compulsory, there are still many matters that need to be resolved, together with the other reforms being considered, before the main advantages of payrolling, namely that tax will be collected on employee BiK in the year that the BiK is provided and the OTS's objective that 99% of P11Ds should no longer be needed, can be achieved.
8. We remain unconvinced that payrolling BiK will ameliorate the workload of most employers. We cannot see that it would be less burdensome to be obliged in every pay period – ie 12 and, for some employees, 52 times a year – to identify, calculate the quantum and include all BiK in the payroll in time to ensure that employees are paid the right amount of net remuneration on every pay day rather than completing one annual P11D return three months after the last transaction that affects the benefit valuation. This problem will be exacerbated for employers who opt to pay NIC in-year, as there is presently no mechanism to recover overpaid NIC.
9. We are concerned that the statement in para 4.8 that there are no plans to introduce the reform required for a 'right first time' model seems to preclude changes to the charging rules. We consider that to make payrolling work the charging rules should be revised as a matter of priority because the existing rules governing the BiK and expenses regimes for tax and NIC do not in many cases lend themselves to real time reporting.
10. This raises the question of how to calculate the charge to tax and NIC on BiK in such a way that amounts payrolled do not need to be revised subsequently, especially at the year end which might necessitate a positive or negative entry in a payroll calculation in the following tax year (which might mean having to undertake a reconciliation) or in a form P11D. Having to adjust payroll or complete form P11D to return an adjustment to a BiK, whether an 'over' or 'under', will add to employers' workloads.
11. In addition, payrolling seems to us to necessitate review of the NIC rules, notably:
 - the rule that charges Class 1A NIC on the full amount even where there is, say, 50-60-70% business use, which is inconsistent with the tax treatment, and
 - the NIC treatment of various expense items which depends on the legal status of the contract (telephones/home broadband and mobile phones being obvious examples where Class 1 or Class 1A can apply).
12. Without a fundamental review of the charging rules for both tax and NIC we are replicating the blue box/brown box P11D annual quandary with the same quandary every payday.

13. Payrolling might also make it timely to consider raising the £1,500 threshold below which employers can remit PAYE to HMRC quarterly.
14. We should also welcome confirmation that where BiK are payrolled, there will be no obligation on employers to submit the same information on form P11D or equivalent.
15. We consider that employers should be obliged to provide details to employees of payrolled BiK on payslips, leaver statements and end of year form P60. This will help to make it easier for employees to spot whether they are paying tax on BiK twice, once through payroll and again via their code numbers. Payroll software and HMRC's Basic Payroll Tool (BPT) will need to be modified to enable this. This will also enable HMRC to collect information about BiK on the RTI full payment summary, should they want it. Sufficient time needs to be given to software developers for a full consultation on the changes and for development.
16. Processes need to be developed for employers of cross-border employees, expatriates coming into the UK who are not or cannot be included in a modified Appendix 6 scheme and expatriates leaving the UK, etc which recognise the more complex administrative burden of dealing with the PAYE and BiK of such employees. For example, presently, as part of the Appendix 6 schemes agreement, BiK have to be included but they are included as an estimate rather than in actual amounts, owing to the practical difficulties of collating the data. If payrolling of BiK is introduced, payrolling of BiK in Appendix 6 schemes needs to continue to be viewed as distinct and different from the payrolling of BiK for normal, ie non-expatriate, employees in normal, ie non-modified, schemes.

RESPONSES TO CONSULTATION QUESTIONS

Chapter 4: A voluntary payrolling model

Q1: Do respondents agree that a voluntary payrolling framework presents the best overall opportunity for simplification?

17. We agree that a voluntary payrolling framework so that employers can choose whether to payroll and which BiK and employees are covered, presents the best overall opportunity for simplification, because a voluntary framework will allow more time for employers to adapt their processes and systems to make payrolling work for them.
18. Also, as noted by the OTS, payrolling will not work for all employers.
19. Another reason for a voluntary payrolling regime is that BiK are often administered by different parts of a business and some will feed more easily and on a more timely basis into the payroll runs than others. For example, company cars will generally be a one-off adjustment and then a constant monthly amount but services provided to employees, directors' loan accounts etc may be sporadic and easier to deal with at year end.
20. We agree with the guiding principle in the second sentence of condoc para 4.8, ie that payrolling needs to be simple to operate.

Q2: Should employers have to payroll all BiKs endorsed by HMRC, or choose freely from a set 'approved' list produced by HMRC to suit their business?

21. For the same reasons outlined in the answer to Q1, we consider that employers should be able to choose freely which BiK they payroll on the basis of whether they have the processes and information, rather than have to payroll all BiK endorsed by HMRC or select from an HMRC 'approved' list.
22. We believe that despite the statement in the first sentence of para 4.8 that there are no plans to reform PAYE to enable the introduction of a 'right first time' payrolling model, in the longer

term the rules for taxing BiK should be changed, after consultation, so that payrolling of BiK can achieve a right first time objective.

Q3: Should payrolling apply to all employees within a PAYE scheme subject to a limited number of exceptions and special cases, what should these exceptions be?

23. Payrolling should be able to apply to whichever employees the employer chooses. Any BiK not payrolled will fall to be reported on form P11D or a PSA, so whatever the method used to report BiK, there will be no tax/NIC loss to the exchequer.
24. We suspect that in practice employers will apply payrolling of BiK to all employees of the same category, but we consider that they should be free to choose which employees because payrolls may include employees of different types for whom the employer does not want or finds impractical to payroll benefits. For example, as envisaged in para 4.23, a company may want for reasons of confidentiality not to payroll the BiK of the directors and senior management but instead return their BiK on form P11D, or may find it impractical to payroll the BiK of employees based overseas owing to the time it takes to transmit the necessary information to payroll given that real time information requires pay details to be submitted to HMRC (normally) on or before payday.
25. Modified Appendix 6 Schemes should continue to be available for tax equalised inbound expatriates, and not included in the new payrolling of BiK regime, ie, they should continue to include estimates of BiK in the monthly payroll calculations.
26. Appendix 7 Schemes should be reviewed and the restrictions on who may be included relaxed to facilitate the payrolling of BiK. For example, it should be possible to include employees who receive BiK when working abroad but who remain UK resident and are not tax equalised

Q4: What might cause an employer to need to cease payrolling? Would employers prefer payrolling arrangements to be irrevocable once entered into, or for HMRC to develop terms of withdrawal which accommodate the necessary protection?

27. Ideally, as recommended in para 4.16, payrolling should be on an annual basis as moving employees in and out of payrolling of BiK will make it very difficult to determine employee code numbers, unless HMRC's processes for doing so and notifying employers and employees are speeded up.
28. However, in practice employers will need to be allowed to cease payrolling mid-year because of a variety of factors; we therefore believe that HMRC should develop terms of withdrawal.
29. Employers might need to withdraw from payrolling certain BiK or for certain types of employee because:
 - they have been over optimistic as to their own capabilities or as to how long it takes to get the correct information to payroll, or
 - they might change payroll provider to one that does not support the payrolling of BiK, or
 - merge or are taken over, or
 - change their systems and processes, or
 - there may be changes in the law which make payrolling impractical.
30. If payrolling is irrevocable or employers perceive that the terms of withdrawal are too onerous, then this may discourage employers from starting to payroll any BiK.

Q5: Would respondents welcome the option to account for Class 1A NICs in real time where the BiKs were being payrolled?

31. We recommend that HMRC offers the option of accounting for Class 1A in real time where BiK are payrolled, in addition to the existing regime of being able to settle up by the current due date (19th/22nd July following the year end) using P11D(b).
32. In principle it would be logical for tax and Class 1A NIC to be accounted for at the same time, but given the cash flow disadvantages to employers we doubt whether this would be taken up by all in the first instance unless some incentive is offered. It should not be compulsory.
33. We are also apprehensive about the ability of HMRC's employer PAYE accounts properly to distinguish Class 1A NIC paid in real time from tax and Class 1 NIC. If Class 1A is to be paid in real time, HMRC needs to ensure that it has a robust system to account for payments of Class 1A NIC, deal with misallocations, etc. The current procedure for dealing with disputed charges and reconciliation queries is not robust enough as evidenced by HMRC's recent letters asking employers to wait for three months for an update. This is not an acceptable time scale.
34. Employers are also unlikely to opt for 'pay as you go' NIC if they cannot recover overpayments promptly and automatically. The RTI Joint Task Force (set up by representatives of employers/payroll agents/bureaux and software houses) and HMRC's Employer Consultation Forum has alerted HMRC to many instances where employers have been unable to recover overpayments of PAYE from HMRC. We therefore suggest that HMRC needs to introduce a mechanism to repay overpaid PAYE and Class 1A NIC automatically.
35. Payroll software and HMRC's Basic Payroll Tool and Debt Management & Banking IT will need to be redesigned to enable Class 1A NIC to be paid monthly and repayment claims to be processed and paid automatically. Sufficient time will be needed to consult with software houses and allow for development.

Chapter 5: Errors, omissions and PAYE

Q6: For employers experienced in payrolling, what are the most common reasons for errors in the amount of tax deducted, and what actions are commonly taken to address this, in particular after the payroll has closed?

36. Most errors arise from incorrect data having been applied in the payroll calculations, most commonly because the wrong code number has been issued by HMRC. Presently wrong code numbers arise because BiK have not been processed properly from forms P11D, particularly one-off BiK, and s.336 claims have not been taken into account. The form P11D does not request the correct information to enable the correct codes to be issued. Agents and taxpayers then view the code as incorrect because it is collecting the wrong tax. Unfortunately HMRC statistics view the code as correct because it has been issued according to the correct procedures.
37. Too many week1 / month 1 codes are issued. See further comments below. Other errors come about because data has been received by payroll too late to be applied in that month's calculations, as in the examples cited in para 5.3.
38. The most common way of addressing an understated BiK is to include an entry in P11D as a one-off benefit. If a benefit has been overstated then the P11D needs to be able to include a negative benefit figure. We should welcome clarification as to whether HMRC will make a negative code number adjustment in such circumstances.
39. Real time information effectively precludes corrections to payroll after the payroll year end as this involves filing a late full payment submission which introduces the risk of incurring interest and penalties. In order to collect underpaid tax or refund overpaid tax any adjustment would have to be as part of the payroll run for a pay period in the new payroll year. However this means that the benefit is being taxed or adjusted via PAYE in the wrong year.

40. As a separate point, if a BiK has been payrolled then employers should not be obliged to notify that BiK to HMRC again, eg on form P11D or a spreadsheet, as has been the requirement in the past.

Q6A: Do you agree that where tax is under-deducted the government should follow the existing rules for PAYE, retaining recourse to the employer using existing principles?

41. We agree in principle that existing rules should apply. However, where tax is under collected in one pay period and a correction is made in a subsequent period, perhaps in the following tax year, then this should be sufficient redress.

Q6B: What other exceptions exist where new PAYE rules may be required, for example, where HMRC issue a tax code to be operated on a week 1 / month 1 basis?

42. HMRC should determine what percentage of codes in operation at the 5 April 2014 were on a week 1 / month 1 basis and review their procedures for issuing such code numbers. HMRC also need to use the information supplied under RTI in real time to update code numbers etc.
43. In recent years, HMRC has been issuing week 1/month 1 code numbers in the final three months of the tax year, rather than cumulative code numbers. This distorts the working of the PAYE system. We therefore consider that HMRC should issue cumulative codes at all times of the tax year unless there are circumstances which would dictate otherwise, eg large increase in tax liability.
44. Across the board there needs to be a rule similar to that for K codes, whereby the employee does not suffer tax that makes his take home pay less than 50% of gross pay.
45. A rule will be needed for one-off BiK if it is not decided to introduce a 50% rule. In this case perhaps the employer/ employee could choose to have tax collected on one-off BiK over the remaining portion of the tax year, or over the next twelve months.

Chapter 6: Statutory rules and exceptions

Q7: The Government is interested to hear from employers experienced in payrolling on dealing with the issues covered at paragraphs 6.1 – 6.5. *[Editorial note: ie, where payroll is run before the end of the pay period; nil or insufficient pay from which to collect the tax on the BiK; and one-off benefits – statutory maximum tax collectable, eg 50% ?]*

What are employers' experiences of this, and do the options described provide workable alternatives?

46. As noted in the answer to Q6B, there needs to be a rule similar to that for K codes, whereby the employee does not suffer tax that makes his take home pay less than 50% of gross pay.
47. Company cars are generally fairly easy, although there is a time lag when employees change their cars. It can be a few weeks between the provision of a company car and when payroll receives details of the list price, CO₂ emissions etc. There would need to be some flexibility in the system to allow for a change in taxable benefit caused by a change in car to be adjusted in the payrolling system, possibly in a subsequent year.

Chapter 7: Common practical issues [encountered by employers who payroll BiK]

Q8: *Company Cars and Fuel*

a) How do employers deal with any payments or contributions for private use made retrospectively, and particularly those made from 6 April to 6 July?

48. We suggest that HMRC ask employers which they know are payrolling BiK what they do in practice.

49. In general terms, employers who have payrolled a car benefit and then receive a contribution from the employee between the end of the tax year and 6 July might either insert a suitably worded entry on P11D or put a negative entry on the employee's April, May or June payroll (and if appropriate seek funding from HMRC to cover the tax refund). They may well seek advice from their customer relationship manager (CRM) if they have one or HMRC's employer helpline.

b) Do employers continue to submit form P46(Car) to report changes?

50. We imagine that HMRC is best placed to answer this question.

Q9: PMI (or gym membership fees) paid on behalf of the employee

- a) Where the policy renewal period falls part way through the tax year, unless the premium for the year is agreed in advance, what value is payrolled? Do employers project a value based on a previous year premium, or estimate the premium and begin payrolling on that basis and adjust once premium for that year is agreed? [or]
b) Do employers payroll the total annual premium in the month paid?

51. We suggest that HMRC asks employers which they know are payrolling BiK what they do in practice.
52. In general terms, the way in which PMI and gym membership subscriptions are payrolled depends on the contract between the employer and the insurer/gym. In our experience, many employers payroll such subscriptions on a monthly basis and adjust when there are known changes.
53. Where such subscriptions are payrolled, the monthly amount attributed to each individual is much more transparent. Employers will want to undertake the task of attributing subscriptions to individuals once a year, not every month. Problems can arise when someone leaves, because the full amount of the subscription attributable to that individual may not be able to be payrolled and the tax collected thereon before the employee's final payday, or, in a block scheme, a fixed overall subscription may have to be attributed to fewer remaining members. Employees for whom subscriptions are payrolled may become concerned if their payslips show different subscriptions each month, whereas if the subscription is returned on form P11D, all the employee will see will be just one figure for the whole year on his copy form P11D.
54. A major difficulty with PMI and gym membership subscriptions arises in April for employers whose staff are on flexible benefits packages which follow the tax year, when the new year's details of staff selecting medical benefit (including for family) may not be available in time for the April payroll run. The employer has to decide whether to process April's or April's and May's payroll run on the basis of the previous year's information and then adjust in May or June respectively.

Q10: One off large BiKs in the form of the transfer of an asset (a property or valuable antique)

These items with a large tax charge will require a significant deduction of tax in a single pay period.

- a) Do any employers payroll these items? If so, are how are they dealt with? Do employers spread the value of these across the remainder of the year or do they payroll the total in one pay period, or
b) Do employers report items on a P11D with a note that it is a one off?

55. We suggest that HMRC ask employers which they know are payrolling BiK what they do in practice, but our evidence suggests that most employers presently report one-off BiK on form P11D because this is easiest.

56. We are concerned that BiK reported on form P11D with a note that they are one-off are too often treated by HMRC as continuing when calculating code numbers. As most P11Ds are submitted and processed by computer there needs to be a box on the P11D to show a one-off benefit and also a benefit ceased box, and this information needs to flow through to PAYE codes. These changes would prevent a lot of wrong code numbers being issued and save a lot of calls to HMRC's contact centres.
57. We would suggest that if one-off BiK are to be payrolled, then they should be subject to PAYE across the rest of the year or even over the next twelve months, for example for a monthly payroll, one twelfth payrolled each month.

PCB

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax/tax-faculty/-/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)