



ICAEW REPRESENTATION 155/16

TAX REPRESENTATION

SIMPLIFYING THE PAYE SETTLEMENT AGREEMENT (PSA) PROCESS

ICAEW welcomes the opportunity to comment on the consultation document [*Simplifying the PAYE Settlement Agreement \(PSA\) process*](#) published by HMRC on 9 August 2016.

The timing of this consultation document, issued in a similar timeframe to about thirty other papers seeking comments, has restricted the time we have been able to spend on this response.

This response of 19 October 2016 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.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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MAJOR POINTS

1. We are disappointed that the scope of PAYE Settlement Agreements (PSAs) is not being widened to enable any employer-provided benefit-in-kind (BiK) and expense to be included, as recommended by the Office of Tax Simplification (OTS). We view not doing this as a missed opportunity to simplify and streamline the operation of the tax system, especially in the light of recent, prospective and proposed changes to BiK and expenses rules.
2. We consider that:
 - It would be a simplification for PSAs not to have to be formally agreed, but the removal of the need for employers to obtain HMRC's agreement that the BiKs included in PSAs are acceptable may lead to a drop in compliance. Preferably the legislation and HMRC guidance will need to be very clear, and any changes should be well flagged in advance of commencement, eg via Employer Bulletin;
 - The replacement of paper forms with a digital form needs to be underpinned with robust software that does the job properly. This will necessitate HMRC making available detailed IT specifications well in advance and processing correctly data that employers submit. If this is not possible, then go-live should be delayed for a year;
 - The deadline for PSA calculations and the payment date for PSA tax and Class 1B NIC should be left as they are rather than be aligned with those for BiK reported via forms P11D, as there are several good reasons for the July calculation deadline and the October PSA paydate, eg, the time it takes to get BiK information from abroad, being able to use PSAs easily to sweep up BiK which otherwise might not be reported and to give HMRC time to check and where necessary challenge PSA calculations;
 - As noted above, PSAs should be able to include any BiK and expense, as recommended by the Office of Tax Simplification, and HMRC should not be trying to restrict their use. PSAs are simple for employers to operate and employers accept that the quid pro quo is that PSAs are more expensive for them (and therefore more lucrative for the exchequer – see Appendix 2) than P11D reporting because of the grossing up of PSA tax and the calculation of NIC on the grossed up BiK. Employee NIC contributors are not disadvantaged if BiKs are reported via PSAs rather than on forms P11D (or via payroll/P11D(b) if payroll BiK) because neither Class 1A NIC nor Class 1B NIC augments contributors' NIC records;
 - If PSAs are going to continue to be restricted, then we suggest that in the light of the difficulty in defining in simple terms the meanings of 'minor' (or 'trivial'), 'irregular' or 'impractical', HMRC provides (at least for the first couple of years of the new regime) a facility to enable employers to obtain confirmation from HMRC that particular BiKs that they wish to include in a PSA which do not readily fit into the terms of the guidance are (or are not) acceptable, and publishes the results of such inquiries to build up a body of guidance to help others; and
 - If HMRC is no longer going to agree what is in a PSA, then perhaps the term 'Agreement' should be dropped.

RESPONSES TO CONSULTATION QUESTIONS

Chapter 3: Proposed new process

Remove the requirement for upfront agreement

Qi Do you agree that removing the requirement to agree the items in a PSA will provide simplification for employers? Please give your reasons.

3. We agree that removing the requirement to agree items in a PSA would be a simplification for employers as it would obviate the need to liaise with and await confirmation of the PSA from HMRC and therefore save time. However, employers will be disadvantaged as they will lose the certainty provided by HMRC approval, especially where the PSA includes non-standard BiK.

4. Removing the requirement to agree items in a PSA in advance could help employers if the changes to salary sacrifice go ahead provided the BiK that can be included in a PSA are not overrestricted because there will be a lot more items that employers may wish to include in a PSA as new taxable BIK will exist, for example workplace parking if provided by salary sacrifice (and others with unexpected values) (which means that employee and employer familiarisation and very clear guidance is needed as soon as possible for policies and processes to be ready by April 2017).

Qii. Are there reasons why the formal agreement element of a PSA should be retained? If so, what changes should the government consider to an agreement based system so that it is easier to administer?

5. We believe that employers should still be able to obtain clearance from HMRC, especially where HMRC's guidance about which BiKs can be included in a PSA does not cover a BiK that the employer is considering.

Considering a digital solution

Qiii. Do you agree that a having a digital PSA return would be simpler for employers to administer rather than the current PSA1 paper return? Please provide your reasons.

6. A digital PSA return potentially could be simpler than having a paper PSA1 return. This is on the assumption that the employer has access to the appropriate software and an adequate broadband connection and that the software works properly. This presupposes that sufficient time is allowed before go-live for HMRC to draft and issue comprehensive IT specifications and for HMRC and software houses to build, test and install the software, write and publish guidance and train users, and that HMRC processes correctly the data that employers submit so that employers are not having to correct HMRC mistakes. We do not wish to see a repeat of the problems that affected share reporting for example.

Qiv. A digital return would reduce error rates. Are there other changes the government should consider to reduce these further?

7. As to the types of BiK that can be included, HMRC needs to ensure that its guidance on PSAs is comprehensive and easy to understand and includes lots of examples of what BiK can be included and what employers should do by when, etc. A digital return could increase error rates if the software is not fully tested.

PSA return and payment dates

Qv. Would aligning the PSA payment date with the Class 1A NICs payment deadline cause any employers particular hardship? Please provide your reasons

8. The alignment of PSA payment dates with the Class 1A NIC payment date would cause hardship to employers for several reasons, explained below. This would be exacerbated if the date by which HMRC expects employers to report PSA tax and Class 1B liabilities were brought forward.
9. First, advancing the payment date by three months from 19/22 October to 19/22 July would represent a considerable cash flow disadvantage for employers.
10. This would be compounded by the fact that PSA tax and Class 1B NIC are calculated on a grossed-up basis. This means that the cost to the employer in terms of tax and Class 1B NIC of a PSA covering higher rate taxpayers is over six times more than the Class 1A NIC cost of the same BiK provided to the same employees reported through P11D (see calculations in Appendix 2).

11. Secondly, if the PSA calculation and payment deadlines were brought forward to 6 July and 19/22 July respectively they would add to other July employer deadlines and therefore be extremely burdensome for employers.
12. Thirdly, keeping the existing 31 July calculation and October payday for PSAs gives time to employers to ensure that they have included all BiK that should have been.
13. Fourthly, the October payday enables employers to cope with the challenge of getting documentation on BiK from overseas subsidiaries in respect of in-pats and secondees.
14. Fifthly, the date for submitting a PSA return and paying the tax and Class 1B NIC needs to be later than the Class 1A payday to enable employers who want to comply to cope with recent and prospective changes to the way in which BiK and expenses are reported to HMRC, ie to pick up BiK and expenses that were unable to be payrolled by the end of the year.
15. The main change from April 2016 are payrolling of BiK, albeit voluntary, and exempt expenses which have rigid rules that many employers are finding it difficult to get to grips with and employers are still awaiting guidance on how to deal with BiK and expenses that cannot be processed within the year (promised for February 2017 Employer Bulletin). The PSA would provide an administratively simple way for employers to account to HMRC for BiK and expenses which it has not been possible to account for via P11D (or payroll & P11D(b) if payrolling).
16. Whilst the contents of a PSA are not within the strict terms of this consultation, we believe that enabling employers to use a PSA to sweep up such unprocessed BiK and expenses would represent a considerable saving in compliance costs. However, using a PSA for this purpose would not be possible if the PSA payment date were to be advanced to 19/22 July. It should be borne in mind that the quid pro quo of the administrative saving to employers of PSAs is the additional bottom line tax and Class 1B NIC that they have to pay HMRC owing to these figures being computed on the grossed up basis referred to above. Extending the scope of PSAs would also help smooth the introduction of digital tax accounts for taxpayers.
17. Similarly, a major prospective change is in respect of BiK provided via salary sacrifice. If this goes ahead there are likely to be more BiK that employers will need to include in PSAs. This is because BiKs will exist that do not currently, for example workplace parking (and others with unexpected values) if provided by salary sacrifice (this will need employee and employer familiarisation and very clear guidance as soon as possible for policies and processes to be developed by April 2017). Again the quid pro quo is the additional tax/Class 1B NIC cost to employers.
18. At present, we understand that, provided that the PSA BiK figures are submitted to HMRC by the end of July, HMRC guarantees to advise employers of the PSA tax and Class 1B NIC liability in time to meet the 19/22 October payment due date. This timescale is later than the Class 1A payday and enables employers to ensure that BiK not already accounted for can be included in the PSA. This timescale is essential to give employers time to ensure that all BiK are included and we believe that the ability to submit the PSA calculations later than the P11D should remain, along with the 19/22 October payday.
19. Finally, an October payday also gives HMRC time to check and, where necessary, challenge PSA calculations.
20. In the light of the forgoing, we can see no advantages for employers or HMRC of aligning the PSA payment date with the Class 1A NIC payday.

Handling differences of opinion

Qvi. Do you agree that this approach would be proportionate?

21. Provided HMRC's guidance is clear and unambiguous, the coming into effect of updates are clearly dated on gov.uk and flagged in Employer Bulletin and the warnings properly reflect what employers have returned then this process would not be unreasonable.

Qvii. Do you have any other comments about the proposed new PSA process?

22. In the light of the number of recent and prospective changes to payroll and BiK reporting processes, we suggest that HMRC provides a further opportunity to comment once responses to this consultation have been collated.

Chapter 4: Defining what can be included in a PSA

Minor

Qviii. In light of the new trivial BiKs exemption, would the removal of 'minor' pose any problems for employers? Please provide reasons for your answer and examples of BiKs which this would cause difficulty for.

23. As a general point, we agree with the OTS that any BiK and expense should be able to be included in a PSA. This is especially the case as not all minor benefits will be covered by the trivial benefits exemption (eg rewards for service). If this is not done, we believe that an opportunity to make the tax system more efficient and to smooth the introduction of digital accounts will have been missed.

24. However, if the BiK that can be included in a PSA are going to continue to be restricted then we recommend that if 'minor' is to be removed then it should be replaced by 'trivial' so rewards such as drinks are covered.

Qix. Are there items which you include in your current PSA which are 'minor' and which are not either 'irregular' or 'impracticable' as well?

25. As we are responding as a representative body we are not commenting on this question.

Irregular

Qx. Do you agree that these principles should guide what can/cannot be included in a PSA as an 'irregular' item?

26. As a general point, we agree with the OTS that any BiK and expense should be able to be included in a PSA. If this is not done, we believe that an opportunity to make the tax system more efficient and to smooth the introduction of digital accounts will have been missed.

27. However, if the BiK that can be included in a PSA are going to continue to be restricted then the criteria cited in the consultation document are reasonable to define 'irregular' with the following exception.

28. We question the exclusion for 'items that employees have a contractual right to' as this will exclude BiK that are part of the employer's business, for example the right to free travel in a public transport operator or free breakdown cover where the employer provides breakdown services. The consultation document refers to bonuses excluded from PSAs by legislation. We therefore recommend, on the assumption that it is not intended to exclude BiK that are part of the employer's trade just because they may be contractual, that the additional 'irregular' criteria be reworded to allow BiK that are part of the employer's business.

29. Also, if there is a staff suggestion scheme where a different person wins every month is that irregular (because it is irregular for the employee) or regular (because it is regular for the employer)? What if in a genuine selection process the same employee wins four monthly prizes in a tax year, with three of them in consecutive months?

30. The foregoing points illustrate the sort of difficulties that will arise if HMRC removes the ability of employers to obtain confirmation that the BiKs that they want to include in a PSA are acceptable. The same applies to ‘minor’/‘trivial’ and ‘impractical’ and is probably why PSAs have always required HMRC agreement. We therefore recommend that HMRC leaves open (at least for the first couple of years of the new regime) a facility so employers can obtain confirmation that particular BiKs that they are considering including in a PSA which do not readily fit into the terms of the guidance are (or are not) acceptable, and publishes the results of such inquiries to build up a body of guidance to help others.

Qxi. Are there any other principles which you think should be considered?

31. See answer to Qx.

Qxii. Do you have any other comments about how ‘irregular’ is interpreted?

32. See answer to Qx

Impractical

Qxiii. Do you agree that these rules provide clarity? Would their application pose any difficulties for employers?

33. As a general point, we agree with the OTS that any BiK and expense should be able to be included in a PSA. If this is not done, we believe that an opportunity to make the tax system more efficient and to smooth the introduction of digital accounts will have been missed.

34. However, if the BiK that can be included in a PSA are going to continue to be restricted then we agree that the criteria cited in the consultation document are reasonable to define ‘impractical’.

Qxiv. Are there any other types of ‘impracticability’ which the government should consider?

35. .See answer to Qxiii.

Office holders

Qxv. Should the government consider an exemption/cap in respect of office holders? Please provide reasons for your answer.

36. This question seems to misunderstand that PSAs are not an exemption but a way to enable employers to report and pay tax and NIC on BiK. We therefore see no reason to impose an exemption or cap on officeholders. Indeed, we believe that HMRC should encourage employers to enter into PSAs as they are simple for employers. They are also lucrative for the exchequer owing to the fact that PSA tax and Class 1B NIC are calculated on a grossed up basis – the exchequer ‘take’ on a BiK reported in a PSA is materially greater than when the same BiK is reported in the normal manner (see Appendix 2).

Qxvi. What other safeguards could/should be considered to guard against possible abuse of PSAs?

37. The best way to counter abuse by any employer is for HMRC to undertake compliance activity – and for HMRC to let this be known.

The scope of PSAs

Qxvii. Are there any compelling reasons/scenarios which do not fit into the rules as set out above that employers feel the PSA process should be amended to include? Please provide reasons/examples.

- 38.** Regarding paragraph 4.23, we consider that government/HMRC, when imposing new processes, should have regard to how easy it is for employers to comply and the fact that most employers do want to comply but do not wish to have to waste their time in surmounting seemingly unwarranted obstacles to do so. Recent incremental changes to payroll and BiK reporting both in place and in the pipeline are making payroll and BiK reporting more complex rather than simpler and internationally some employers feel that the UK is becoming a more difficult – and therefore costly – place in which to locate staff.
- 39.** PSAs are to enable employers to provide BiK without having to allocate them to employees other than in general terms, eg to estimate the respective numbers of basic/higher/additional rate employees who benefit. We consider that the proposals in the consultation document are aimed at restricting what can be included in a PSA whereas we agree with the Office of Tax Simplification that a PSA should be able to include anything. A PSA does not result in a loss of tax or NIC – on the contrary, as noted in our calculations in Appendix 2, the tax and Class 1B NIC exchequer ‘take’ from a PSA for a 40% taxpayer is 66% more than ‘take’ from a BiK reported on forms P11D (or accounted for in payroll), so if HMRC has a perception that PSA represents a disadvantage to the exchequer then we should welcome sight of figures.
- 40.** Also, on an individual taxpayer basis, Class 1A NIC on BiK does not augment contributors’ NIC contribution records so from this viewpoint it is irrelevant whether the BiK is reported on P11D/payrolled or in a PSA.
- 41.** We suggest that the following specific items should be able to be included in a PSA:
- foreign tax paid on behalf of expat employees, as well as loans covering such payments;
 - accommodation and subsistence where it is believed that it qualified for temporary workplace relief but circumstance change and there has been a delay in amending the payroll etc;
 - tax return preparation costs for expat employees;
 - certain benefits which would otherwise require an amendment to a digital account (this is to smooth the introduction of digital accounts); and
 - BiK provided after leaving.
- 42.** We also consider that if restrictions are going to be imposed on what can be included in a PSA then there should be grandfathering.

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 via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).

APPENDIX 2

TAX AND NIC COMPARISONS: PSA v P11D/payrolling

Where a BiK is reported in a PSA, the tax due is grossed-up at the employee's marginal rate. For example, £5,000 of benefits provided to higher rate (40%) taxpayers would be grossed-up as follows:

Tax grossed up $\text{£}5,000 \times 40/60 = \text{£}3,333.33$.

Class 1B NIC $\text{£}5,000 + 3,333.33 = \text{£}8,333.33 \times 13.8\% = \text{£}1,150.00$.

PSA tax $\text{£}3,333.33 + \text{Class 1B NIC } \text{£}1,150.00 = \underline{\text{£}4,483.33}$

Direct cost to employer is tax and Class 1B NIC of $\text{£}4,483.33$

If the BiK had been reported on P11D (or through payroll for income tax if employer has registered for payrolling and P11D(b) for Class 1A NIC):

Tax would be $5,000 \times 40\% = \text{£}2,000.00$.

Class 1A would be $\text{£}5,000 \times 13.8\% = \text{£}690.00$.

P11D tax & Class 1A NIC total $\text{£}2,000.00 + \text{£}690.00 = \underline{\text{£}2,690.00}$.

Direct cost to employer is Class 1A NIC of $\text{£}690.00$ only as employee pays the tax.

Comparison from employer viewpoint

Difference between PSA tax & Class 1B NIC and Class 1A NIC is $\text{£}4,483.33 - 690.00 = \text{£}3,793.00$.

The PSA tax and Class 1B NIC is over six times the Class 1A NIC.