



Income tax: simplifying the administration of employee expenses, including preventing salary sacrifice

Who is likely to be affected?

Employers who pay, reimburse, or provide benefits in kind (BiKs) in respect of expenses incurred by their employees.

Employees who receive payments or BiKs in respect of expenses they incur.

General description of the measure

This measure will simplify the administration of tax relief for employee expenses where the employer pays or reimburses them, or provides BiKs in respect of them.

Policy objective

This measure makes the administration of employee expenses simpler. It removes the reporting requirement and the requirement for employers to apply to HM Revenue & Customs (HMRC) for an agreement, known as a “dispensation,” in order to pay qualifying expenses and BiKs free of tax. It also more closely aligns the tax rules to the existing National Insurance contributions (NICs) treatment of expenses payments.

The measure also prevents expenses being paid free of tax and NICs as part of a ‘salary sacrifice’ arrangement. These arrangements require the employee to give up a right to a part of their salary in exchange for the payment of those expenses, in order to reduce the NICs liabilities of both the employer and employee.

Background to the measure

The measure was announced by the Chancellor at Budget 2014 as part of a package aimed at simplifying the administration of employee BiKs and expenses. This followed the Office for Tax Simplification’s review of employee BiKs and expenses, and recommendations made in their interim and second reports published in August 2013, and January 2014.

A consultation document entitled ‘Employee benefits and expenses: exemption for paid or reimbursed expenses’ was published on 18 June 2014. The consultation ran until 9 September 2014. A summary of responses to the public consultation has also been published on the government website today.

Detailed proposal

Operative date

This measure will have effect for all expenses payments and BiKs provided on and after 6 April 2016.

Current law

Under the Benefits code in Part 3 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), expenses payments and BiKs are treated as “earnings” and so are charged to income tax.

Part 5 of ITEPA 2003 provides for deductions from an employee’s earnings for certain expenses that they have to incur in order to perform the duties of their employment.

Section 65 of ITEPA 2003 allows employers to apply to HMRC for an agreement, known as a “dispensation”, to pay or reimburse expenses, or provide BiKs without taxing or reporting them. The legislation requires HMRC to grant a dispensation where it is satisfied that no additional tax is due.

The Social Security (Contributions) Regulations 2001, Schedule 3 provides for payments to be disregarded in the calculation of earnings for the purposes of earnings-related National Insurance contributions. Part VIII of that Schedule covers travelling, relocation and other expenses and allowances of the employment.

Section 10(7A) of the Social Security Contributions and Benefits Act 1992 provides that where a BiK qualifies for a matching deduction under certain provisions of Part 5 of ITEPA 2003 it is not taken into account for the purposes of Class 1A NICs.

Proposed revisions

Legislation will be introduced in Finance Bill 2015 to amend ITEPA 2003 to exempt from income tax expenses payments and BiKs provided to employees where they would have been eligible for a deduction, had they incurred and paid the equivalent expense themselves.

The exemption will also allow employees to be paid a “scale rate” in respect of a qualifying expense, rather than being reimbursed the expense they have actually incurred. This can either be a rate set by HMRC in secondary legislation, or a rate that they have agreed with HMRC. Amendments to regulations will be made to mirror this change for NICs purposes.

Section 65 ITEPA 2003 (which allows dispensations to be granted in respect of expense payments and most non-cash BiKs) and section 96 ITEPA 2003 (the equivalent for non-cash vouchers and credit-tokens) will be withdrawn as part of this measure.

Unlike dispensations, the exemption will not be able to apply to expenses payments or BiKs that are provided as part of a salary sacrifice arrangement. This element of the measure will result in a yield to the exchequer from employers and employees who currently make use of such arrangements. Amendments to regulations will be made to mirror this change for NICs purposes.

Summary of impacts

| | | | | | | |
|------------------------------|--|---------|---------|---------|---------|---------|
| Exchequer impact (£m) | 2014-15 | 2015-16 | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
| | - | - | +120 | +90 | +75 | +75 |
| | These figures are set out in Table 2.1 of Autumn Statement 2014 as <i>Income tax: Salary sacrifice and expenses including umbrella companies</i> and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Autumn Statement 2014. | | | | | |
| Economic impact | The measure is not expected to have any significant economic impacts. | | | | | |

| Impact on individuals, households and families | <p>The change will make it easier for employees who receive expenses payments and whose employers do not currently have a dispensation to receive the tax relief they are entitled to.</p> <p>Employed individuals who are expected to be affected are those whose expenses payments are being made in conjunction with salary sacrifice.</p> <p>This measure is not expected to have an impact on family formation, stability or breakdown.</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|--|---|--------------------------|--|--|-------------|--------------------------|-------------------------|--|--|---------------|------------|-----|----------------------|-----|-----|------------------|------------|-----|----------------------------|--|--|-----------------|-----|-----|------------------------|-------|---|--------------------|--------|-----|--------------------------|--------|-----|--|--|--|-----------------|-----------------|-------------------|-----|-------|--------|
| Equalities impacts | <p>HMRC does not hold data on the protected characteristics of those affected by this measure but this measure is not expected to have equality impacts on groups sharing protected characteristics.</p> | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Impact on business including civil society organisations | <p>This measure will reduce the administrative burden for businesses that pay qualifying expenses or provide qualifying benefits in kind to their employees. Businesses will no longer need to apply for a dispensation for qualifying expenses or report qualifying expenses on P11Ds. This is expected to affect 170,000 to 200,000 businesses. HMRC anticipates an admin burden reduction of £9.3 million per year. HMRC also anticipates a negligible one-off familiarisation cost.</p> <p>As a consequence of the change, it is expected that some employers whose employees use salary sacrifice on expenses will have a higher secondary Class 1 NICs liability.</p> <p>The costs and savings for businesses in complying with the tax system are summarised in the table below.</p> <table border="1" data-bbox="406 1111 1426 1872"> <thead> <tr> <th data-bbox="406 1111 751 1167"></th> <th data-bbox="751 1111 997 1167">Cost</th> <th data-bbox="997 1111 1426 1167">Time Period (yrs)</th> </tr> </thead> <tbody> <tr> <td colspan="3" data-bbox="406 1167 1426 1223">Compliance Costs</td> </tr> <tr> <td data-bbox="406 1223 751 1272">One-off Costs</td> <td data-bbox="751 1223 997 1272">negligible</td> <td data-bbox="997 1223 1426 1272">N/A</td> </tr> <tr> <td data-bbox="406 1272 751 1328">Average Annual Costs</td> <td data-bbox="751 1272 997 1328">N/A</td> <td data-bbox="997 1272 1426 1328">N/A</td> </tr> <tr> <td data-bbox="406 1328 751 1384">Total Costs (PV)</td> <td data-bbox="751 1328 997 1384">negligible</td> <td data-bbox="997 1328 1426 1384">N/A</td> </tr> <tr> <td colspan="3" data-bbox="406 1384 1426 1440">Compliance Benefits</td> </tr> <tr> <td data-bbox="406 1440 751 1489">One-off Benefit</td> <td data-bbox="751 1440 997 1489">N/A</td> <td data-bbox="997 1440 1426 1489">N/A</td> </tr> <tr> <td data-bbox="406 1489 751 1545">Average Annual Benefit</td> <td data-bbox="751 1489 997 1545">£9.3m</td> <td data-bbox="997 1489 1426 1545">5</td> </tr> <tr> <td data-bbox="406 1545 751 1601">Total Benefit (PV)</td> <td data-bbox="751 1545 997 1601">£43.6m</td> <td data-bbox="997 1545 1426 1601">N/A</td> </tr> <tr> <td data-bbox="406 1601 751 1765">Net Benefit (NPV)</td> <td data-bbox="751 1601 997 1765">£42.5m</td> <td data-bbox="997 1601 1426 1765">N/A</td> </tr> <tr> <td colspan="3" data-bbox="406 1765 1426 1821">Impact on Administrative Burden (included in Net Benefit)</td> </tr> <tr> <td data-bbox="406 1821 751 1872">Increase</td> <td data-bbox="751 1821 997 1872">Decrease</td> <td data-bbox="997 1821 1426 1872">Net Impact</td> </tr> <tr> <td data-bbox="406 1872 751 2024">£0m</td> <td data-bbox="751 1872 997 2024">£9.3m</td> <td data-bbox="997 1872 1426 2024">-£9.3m</td> </tr> </tbody> </table> | | | | Cost | Time Period (yrs) | Compliance Costs | | | One-off Costs | negligible | N/A | Average Annual Costs | N/A | N/A | Total Costs (PV) | negligible | N/A | Compliance Benefits | | | One-off Benefit | N/A | N/A | Average Annual Benefit | £9.3m | 5 | Total Benefit (PV) | £43.6m | N/A | Net Benefit (NPV) | £42.5m | N/A | Impact on Administrative Burden (included in Net Benefit) | | | Increase | Decrease | Net Impact | £0m | £9.3m | -£9.3m |
| | Cost | Time Period (yrs) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Compliance Costs | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| One-off Costs | negligible | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Average Annual Costs | N/A | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Total Costs (PV) | negligible | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Compliance Benefits | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| One-off Benefit | N/A | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Average Annual Benefit | £9.3m | 5 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Total Benefit (PV) | £43.6m | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Net Benefit (NPV) | £42.5m | N/A | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Impact on Administrative Burden (included in Net Benefit) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Increase | Decrease | Net Impact | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| £0m | £9.3m | -£9.3m | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

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| Operational impact (£m) (HMRC or other) | It is not anticipated that implementing this change will incur any additional significant costs nor reap any significant savings for HMRC. |
| Other impacts | <u>Small and micro business assessment:</u> the impact of this measure on small businesses is not anticipated to differ from that on large businesses. Other impacts have been considered and none have been identified. |

Monitoring and evaluation

The measure will be monitored and assessed alongside other measures in the government's package of employee BiKs and expenses simplifications, through communication with taxpayer groups affected by the measures.

Further advice

If you have any questions about this change, please contact the Employment Income Policy Team at: employmentincome.policy@hmrc.gsi.gov.uk

1 Abolition of dispensation regime

- (1) ITEPA 2003 is amended as follows.
- (2) Omit section 65 (dispensations relating to benefits for certain employees).
- (3) Omit section 96 (dispensations relating to vouchers or credit-tokens).
- (4) Accordingly, in section 95 (disregard for money, services or goods obtained), omit subsection (1)(b) and the “or” before it.
- (5) The amendments made by this section have effect for the tax year 2016-17 and subsequent tax years.

2 Exemption from income tax for amounts which would otherwise be deductible

- (1) In Part 4 of ITEPA 2003 (employment income: exemptions) after Chapter 7 insert –

“CHAPTER 7A

EXEMPTION: AMOUNTS WHICH WOULD OTHERWISE BE DEDUCTIBLE

289A Exemption for paid or reimbursed expenses

- (1) No liability to income tax arises by virtue of Chapter 3 of Part 3 (taxable benefits: expenses payments) in respect of an amount (“amount A”) paid or reimbursed by a person to an employee (whether or not an employee of the person) in respect of expenses if –
 - (a) an amount equal to or exceeding amount A would (ignoring this section) be allowed as a deduction from the employee’s earnings under Chapter 2 or 5 of Part 5 in respect of the expenses, and
 - (b) the payment or reimbursement is not provided pursuant to relevant salary sacrifice arrangements.
- (2) No liability to income tax arises in respect of an amount paid or reimbursed by a person (“the payer”) to an employee (whether or not an employee of the payer) in respect of expenses if –
 - (a) the amount has been calculated and paid or reimbursed in an approved way (see subsection (6)),
 - (b) the payment or reimbursement is not provided pursuant to relevant salary sacrifice arrangements, and
 - (c) conditions A and B are met.
- (3) Condition A is that the payer or another person operates a system for checking –

- (a) that the employee is, or employees are, in fact incurring and paying amounts in respect of expenses of the same kind, and
 - (b) that a deduction would (ignoring this section) be allowed under Chapter 2 or 5 of Part 5 in respect of those amounts.
- (4) Condition B is that neither the payer nor any other person operating the system knows or suspects, or could reasonably be expected to know or suspect—
 - (a) that the employee has not incurred and paid an amount in respect of the expenses, or
 - (b) that a deduction from the employee's earnings would not be allowed under Chapter 2 or 5 of Part 5 in respect of the amount.
- (5) "Relevant salary sacrifice arrangements", in relation to an employee to whom an amount is paid or reimbursed in respect of expenses, means arrangements (whenever made, whether before or after the employment began) under which the employee gives up the right to receive an amount of general earnings or specific employment income in return for the payment or reimbursement.
- (6) For the purposes of this section, a sum is calculated and paid or reimbursed in an approved way if—
 - (a) it is calculated and paid or reimbursed in accordance with regulations made by the Commissioners for Her Majesty's Revenue and Customs, or
 - (b) it is calculated and paid or reimbursed in accordance with an approval given under section 289B.
- (7) Regulations made under subsection (6)(a) may make different provision for different purposes.

289B Approval to pay or reimburse expenses at a flat rate

- (1) A person ("the applicant") may apply to Her Majesty's Revenue and Customs for approval to pay or reimburse expenses of the applicant's employees, or employees of another person, at a rate set out in the application ("the proposed rate").
- (2) An officer of Revenue and Customs may give the approval if satisfied that any calculation of a payment or reimbursement of expenses in accordance with the proposed rate, or such other rate as is agreed between the applicant and the officer, would be a reasonable estimate of the amount of expenses actually incurred.
- (3) An approval under subsection (2) takes effect in accordance with a notice (an "approval notice") given to the applicant by an officer of Revenue and Customs.
- (4) An approval notice must specify—
 - (a) the rate at which expenses may be paid or reimbursed,
 - (b) the day from which the approval takes effect, that day not being earlier than the day on which the approval notice is given,
 - (c) the day on which the approval ceases to have effect, that day not being later than the end of the period of 5 years beginning with the day on which the approval takes effect, and
 - (d) the type of expenses to which the approval relates.

- (5) An approval notice may specify that the approval is subject to conditions specified or described in the notice.
- (6) An application for an approval under this section must be in such form and manner, and contain such information, as is specified by Her Majesty's Revenue and Customs.

289C Revocation of approvals

- (1) An officer of Revenue and Customs may, if in the officer's opinion there is reason to do so, revoke an approval given under section 289B by giving a further notice (a "revocation notice") to either or both of the following—
 - (a) the person who applied for the approval, and
 - (b) the person who is paying or reimbursing expenses in accordance with the approval.
- (2) A revocation notice may revoke the approval from—
 - (a) the day on which the approval took effect, or
 - (b) a later day specified in the notice.
- (3) A revocation under subsection (1) may be in relation to all expenses or expenses of a description specified in the revocation notice.
- (4) If the revocation notice revokes the approval from the day on which the approval took effect—
 - (a) any liability to tax that would have arisen in respect of the payment or reimbursement of expenses if the approval had never been given in relation to such expenses is to be treated as having arisen, and
 - (b) any person who has made, and any employee who has received, a payment or reimbursement of expenses calculated in accordance with the approval must make all the returns which they would have had to make if the approval had never been given in relation to such expenses.
- (5) If the revocation notice revokes the approval from a later day—
 - (a) any liability to tax that would have arisen in respect of the payment or reimbursement of expenses if the approval had ceased to have effect on that day in relation to such expenses is to be treated as having arisen, and
 - (b) any person who has made, and any employee who has received, a payment or reimbursement of expenses calculated in accordance with the approval must make all the returns which they would have had to make if the approval had ceased to have effect in relation to such expenses on that day.

289D Exemption for other benefits

- (1) No liability to income tax arises by virtue of any provision of the benefits code in respect of an amount ("amount A") treated as earnings of an employee as a result of the provision of a benefit if—
 - (a) an amount equal to amount A would (ignoring this section) be allowed as a deduction from the employee's earnings under Chapter 3 of Part 5 in respect of the provision of the benefit, and

- (b) the benefit is not provided pursuant to relevant salary sacrifice arrangements.
- (2) “Relevant salary sacrifice arrangements”, in relation to an employee to whom a benefit is provided, means arrangements (whenever made, whether before or after the employment began) under which the employee gives up the right to receive an amount of general earnings or specific employment income in return for the provision of the benefit.”
- (2) The amendment made by this section has effect for the tax year 2016-17 and subsequent tax years.

EXPLANATORY NOTE

EXEMPTION FROM INCOME TAX FOR AMOUNTS WHICH WOULD OTHERWISE BE DEDUCTIBLE

SUMMARY

1. Clause [X] introduces a new exemption for expenses which are paid or reimbursed by an employer where the employee would be due a deduction under Chapters 2 or 5 of Part 5 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA). It also provides an exemption in respect of benefits treated as earnings under the benefits code for which there is a deductible amount under Chapter 3 of Part 5 ITEPA. The legislation will come into force on 6 April 2016.

DETAILS OF THE CLAUSE

2. Subsection 1 introduces new Chapter 7A to Part 4 of ITEPA (Employment Income: Exemptions).

3. New section 289A(1) provides an exemption for the amount of paid or reimbursed expenses which would be treated as earnings under the benefits code under circumstances where a deduction would otherwise be due under Chapter 2 or 5 of Part 5 ITEPA. An example of a deductible expense relates to costs necessarily incurred in travel for the performance of an employee's duties. The exemption will not apply if the payment or reimbursement is offered in conjunction with a relevant salary sacrifice arrangement. Relevant salary sacrifice arrangements for paid or reimbursed expenses are defined in new section 289A(5).

4. New section 289A(2) provides an exemption for payments of amounts in respect of expenses that are calculated in an "approved way" (commonly known as 'scale rate or flat rate payments'). An "approved way" for these purposes is defined in new section 289A(6). This requires that sums are calculated and paid either in accordance with regulations made by the Commissioners for Her Majesty's Revenue and Customs (HMRC) under that section, or in accordance with an agreement made under new section 289B. New section 289A(7) enables the power in new section 289A(6) to be used to make provision for different circumstances.

5. The exemption will only apply if the payment is not provided as part of a relevant salary sacrifice arrangement, and if conditions A and B are met, which are defined in new sections 289A(3) and 289(4) respectively. Condition A is that the employer, or a third party, must have a system in place to check that the employers' employees are actually incurring deductible expenses of the same kind, and that they are deductible. Condition B provides a level of protection for employers and third parties operating checking systems – as long as they do not know or suspect (or could not have reasonably been expected to know or suspect)

that the employee is either not incurring the deductible expense or that the expense is not deductible.

6. New section 289B introduces provisions for applying for a flat rate in respect of deductible expenses. This includes, in new section 289B(2) the employer's requirement to provide a reasonable estimate of the actual costs incurred. The flat rate may only be applied if an officer of HMRC approves the application and issues an approval notice as provided for in new section 289B(3). New sections 289B(4) and (5) specify what that notice should or may contain.

7. New section 289B(6) provides that HMRC may specify what information is required and how it is to be set out in an application.

8. New section 289C introduces provisions for revoking approvals and when HMRC may seek to do this. Under new section 289C(2) the revocation notice may revoke approval for the use of the flat rate from the date of the approval notice or from a later date, for example, if the original circumstances of the application had been correct for a period of time before changing. New section 289C(3) sets out that the revocation notice may apply to all expenses or only specified expenses. New sections 289C(4) and (5) set out the effect of the revocation in respect of any tax liability and reporting requirements which arise as a result.

9. New section 289D introduces an exemption for benefits in kind (including vouchers and credit tokens) which the employee would otherwise have been entitled to a deduction for under chapter 3 of Part 5 ITEPA. The exemption will not apply if the benefit is offered in conjunction with a relevant salary sacrifice arrangement, the definition of which is provided for in new section 289D(2).

BACKGROUND NOTE

16. Unless an employer holds a dispensation from HMRC, the value of deductible expenses and benefits which are paid or reimbursed by an employer have to be reported on form P11D – employees can then claim for tax relief on that expense and/or benefit. This leads to unnecessary administrative burdens for employers and employees, and processing costs for HMRC where there is no tax to collect.

17. In response to recommendations from the Office of Tax Simplification as part of their general review of employee benefits and expenses, Ministers have agreed to introduce an exemption with effect from 6 April 2016 for paid or reimbursed deductible expenses and benefits. The effect of this legislation will be that there is no longer any reporting requirement on employers, and employees will automatically receive the tax relief they are entitled to. In addition, there will be no need for dispensations once the exemption becomes effective.

18. This legislation introduces the necessary changes for income tax. Changes will be made to National Insurance contributions (NICs) legislation to mirror aspects of this change for payments that are subject to Class 1 NICs where necessary. For benefits which fall within a liability for Class 1A NICs, current Class 1A NICs legislation automatically mirrors the tax position.

19. If you have any comments about this change, or comments on the legislation, please contact Travis Woodward on 03000 03000 586435 (email: employmentincome.policy@hmrc.gsi.gov.uk).