

AAT RESPONSE TO THE HMRC CONSULTATION ON “EMPLOYEE BENEFITS AND EXPENSES – EXEMPTION FOR PAID OR REIMBURSED EXPENSES”

1 EXECUTIVE SUMMARY

- 1.1 The Association of Accounting Technicians (AAT) is pleased to comment on the issues raised in the HMRC consultation on “Employee Benefits and Expenses – exemption for paid or reimbursed expenses” (condoc).
- 1.2 AAT notes that the main proposal of this consultation is the replacement of the current dispensations regime with a statutory exemption for qualifying expenses that are paid or reimbursed by employers.
- 1.3 AAT supports the proposal in 1.2 (above) as it replaces the current dispensations regime on the basis that it moves employers from a requirement to comply with dispensations and back to complying with Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

2 AAT MEMBERS’ EXPOSURE TO BENEFITS IN KIND AND EXPENSES ADMINISTRATION

- 2.1 Any changes to the rules governing compliance in respect of benefits in kind and expenses administration and management, with the consequent effect on both national insurance and tax treatment of these will affect a significant proportion of AAT members in a variety of different ways. Our members work in accountancy, tax and payroll and hence may be administering expenses reimbursements, managing benefits in kind provision and accounting for these within an accounting system. Furthermore, many will be involved in compliance issues in respect of all forms of transactions involving employees, including the processing of invoices which contain elements of employee administration.
- 2.2 In addition to the above our members in practice may be providing services, advice and guidance to clients who are providing benefits in kind to their employees and will be administering expenses reimbursements on behalf of clients. Members will often be working for the smallest of employers and in a situation where there will be a proportion of low paid employees and it is this group of employees who are often disproportionately affected by any change in the law.
- 2.3 AAT endeavours to participate in all consultations regarding changes that may affect the income tax and national insurance contributions (NICs) calculations, payments and ledger allocation of costs.

2.4 AAT welcomes the condoc which we see as an opportunity to foster full and open debate. While we are in support of many of the views and proposals contained within the condoc, we have some reservations regarding the effects of the proposed changes.

3. OBJECTIVE OF THIS CONSULTATION

3.1 We note that the subject of the consultation is the replacement of the current dispensations regime with a statutory exemption for qualifying expenses that are paid or reimbursed by employers.

4. CURRENT SITUATION WITH EXPENSES REIMBURSEMENTS

4.1 Currently an employer, who wishes to reimburse costs an employee has incurred on company business out of their personal net pay, must have a valid dispensation in place and proper procedures before such payments can be made free of income tax or any other form of assessment.

4.2 Dispensations are relatively straightforward to apply for and obtain, unless it is for a close company where the application of the rules varies from case to case. Anecdotal evidence from HMRC, arising from comments made at the Employment Consultation Forum, indicates that only around 65% of PAYE schemes are known to have a valid dispensation in place. Whether the remaining balance of 35% can be explained by the close company group or if this is in addition to the close companies who have been refused a dispensation is uncertain. It would be useful to have some definitive statistics on this matter.

4.3 The absence of a dispensation renders an employee liable to income tax and Class 1 NICs on reimbursement of expenses. Alternatively the employers would be required to apply Class 1 NICs at the point of payment, and be required to submit a post-year end P11D to account for the income tax liability.

4.4 As a direct consequence an employee will, subsequently, need to submit a claim under s.336 of ITEPA (section 336 claim) in order to block incurring a liability to income tax arising through a restriction to their personal allowances or from direct recovery by the employer, or if that has already occurred, to recover any income tax collected.

4.5 The actions, as described above in 4.4, lead to an onerous administrative burden for employees, employers and HMRC alike. In order for the employee to be able to make a section 336 claim they are required to hold original copies of the expense receipts to validate that they incurred a cost personally. However the requirement for the employee to retain the original receipt prevents the employer from recovering VAT input tax or corporation tax relief.

- 4.6 It is not possible for both employer and employee to hold the original document.
- 4.7 The issue outlined in 4.5 and 4.6 (above) is further compounded by the fact that technically the rule for NIC relief for such payments as contained in Schedule 3 of the Social Security (Contributions) Regulations 2001 are different to those contained within ITEPA. HMRC, however, accept that employers need only satisfy the ITEPA income tax relief rules.
- 4.8 While a dispensation is only valid for five tax years¹, historically they were normally granted for three tax years, before being reviewed by HMRC. Good practice dictates that employers should review their dispensation annually to make sure it has not been invalidated by changes in practice, radical new policies, or failures in the control and checking process.
- 4.9 In practice, few businesses actually carry out any form of review. We believe that many would be unable to produce a copy of the dispensation issued to them by HMRC if asked, which leads us to observe that, while the dispensation rules might be clear they are rarely followed.
- 4.10 We are further concerned that the general process whereby close companies are often refused, on application, a dispensation is inconsistent with HMRC's stated charter principles of "Treating you even-handedly"².

5 THE CONSULTATION DOCUMENT

- 5.1 Prior to responding to the questions posed in the condoc we would like to make the following observations (5.2 – 5.13):
- 5.2 AAT has for many years advocated the removal of the dispensation process or at the very least that it should be turned into a self-certifying process.
- 5.3 We are pleased to acknowledge that the guidance and online dispensation application process is very good.
- 5.4 In many instances the process of validating an expenses claim is driven by standard auditing procedures. Employers are often criticised by external auditors for not having robust expenses reclaim systems in place and a study³ suggested as many as 25% of employee expenses claims were exaggerated, some fraudulently so.

¹ <http://www.hmrc.gov.uk/payerti/exb/schemes/dispensation.htm#1>

² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/91888/charter.pdf

³ <http://www.cipd.co.uk/pm/peoplemanagement/b/weblog/archive/2014/08/29/one-in-four-staff-admit-making-false-expense-claims-study-finds.aspx>

- 5.5 Employers have access to guidance on what is, and what is not, an acceptable payment for tax purposes as well as which ones have to be subject to income tax, either at source, or within the P11D, expenses and benefits in kind reporting system.
- 5.6 AAT advocates a system of self-determination for expenses reimbursement based on the correct application of the rules. If HMRC subsequently finds that the employer has failed to apply the rules correctly then they simply disallow the cost, for PAYE, VAT and corporation tax purposes. This is now standard compliance procedure. If however, an employer is found to have been operating outside of their HMRC agreed dispensation (hence outside the reliefs available in law) the agreement is invalidated and withdrawn. With any payments which might have formerly been outside of the BiK reporting regime, now being subject to income tax and NICs charges as appropriate.
- 5.7 Given the situations outlined in 5.6 all of this leads to the conclusion that dispensation is, in reality, an unnecessary item of administration.
- 5.8 AAT is encouraged to note that our view is now being supported by the condoc proposals.
- 5.9 AAT agrees with the view expressed in paragraph 3.4 (condoc) that removal of the dispensation process would reduce administrative burdens.
- 5.10 We agree with the view expressed in paragraph 3.5 (condoc) that employees will have the exemption automatically and that employers will be able to make reimbursements without further recourse to HMRC because the employer does not have a valid dispensation.
- 5.11 AAT supports the comments made in paragraphs 3.8 and 3.9 (condoc) that there is little value in employers not operating the new exemptions as it would otherwise mean different systems applying to different groups of employees. Furthermore, as observed (3.9, condoc), even if an employer opts-out of the exemption regime, they will still be required to carry out a NIC assessment. This fact leads us to observe that there seems little point in creating this unnecessary anomaly when it can easily be avoided.
- 5.12 AAT supports the comments made in paragraphs 3.11 to 3.14 (condoc), employers do often see the existence of the dispensation as the comforting factor without realising that they carry the same responsibilities as they would if they did not have the dispensation.
- 5.13 In practice many employers have been found to be acting in a non-compliant manner, but take no action simply because they have a dispensation. When identified these employers soon learn that having the dispensation and not complying with the law is worse and attracts a more severe penalty regime. We believe it appropriate to help employers comply with the rules rather than foster the incorrect view that a dispensation protects them, whatever their practices.

6 CONSULTATION QUESTIONS

Question 1: If the Government were to provide 'models' of acceptable record keeping and checking processes would this be helpful for employers? Where the models are not appropriate for employers, would those employers feel disadvantaged, even if it is made clear that they are not exhaustive?

- 6.1 In principle the process outlined in the first half of question 1 would be a practical step as it would benefit affected employers through the provision of clearer guidance in respect of the record keeping requirements. However, AAT considers that it is not a panacea, and we are firmly of the opinion that there are other issues to consider. For example, general accounting principles dictate a higher standard for record keeping.
- 6.2 AAT is concerned that any model record keeping guidance issued in relation to PAYE could cause confusion and lead to a proponent ignoring accounting principles, or the stringent record keeping requirements for VAT and corporation tax.
- 6.3 We are further concerned that some business owners may be confused if their business structure does not fit exactly with the model published in the recorded keeping examples. In such a scenario an employer who considered none of the examples to be appropriate might be confused and disadvantaged and left wondering exactly how they were meant to keep compliant records.
- 6.4 AAT considers it essential to ensure that any published models are clear and unambiguous.
- 6.5 We further consider it to be essential for HMRC to be mindful of the findings arising out of their recent Business Records Check programme; specifically, that a significant proportion of small businesses fail to keep adequate records.
- 6.6 If HMRC were to publish 'models' of acceptable record keeping such an action could raise concerns that it intends to impose penalties of up to £3,000 on businesses for "inadequate records" because the businesses' approach does not follow one of HMRC's published models. To mitigate this risk AAT recommends that HMRC publish a "disclaimer" stating that published models are purely a guide and that other approaches that might prove to be more appropriate to an employer would be equally acceptable.
- 6.7 AAT members would welcome the publishing of "templates" regarding record keeping where their use is voluntary in order to assist new clients with setting up their record keeping or existing clients who may want to improve their record keeping.

Question 2: Are you aware of any types of arrangement that seek to replace taxable pay with payments of non-taxable expenses which the Government should focus on in particular when tackling this issue? Are you aware of any types of these arrangements where tackling them might disturb business practices that are not tax or NICs motivated?

- 6.8 AAT is aware of the recent umbrella arrangement case which established that such arrangements were unlawful⁴.
- 6.9 However, there are clearly some practices which have been set up for genuine business reasons and probably in an effort to produce leaner and more efficient administrative processes. HMRC are right to be concerned that such legitimate schemes should not be jeopardised if they genuinely benefit all parties and do not result in an unlawful loss of revenue to the Exchequer.
- 6.10 While AAT does not have any direct knowledge of any such schemes, we suggest that there is a strongly possibility that they are likely to be found in the oil and gas exploration and similar industries where employees spend significant amounts of time away from home and often offshore as part of their work. Businesses ought to be allowed to create a reimbursement scheme which streamlines administration and produces more efficient and cost-effective reimbursement, particularly when it has no effect on tax revenue.

Question 3: In what circumstances would an employer currently apply for a custom scale rate? Other than the expenses covered by the benchmark scale rates, which expenses do employers commonly request a scale rate for?

- 6.11 AAT is aware that some employers use scale rates to make payments to employees instead of requiring the submission of receipts. For example the current Personal Incidental Expenses rules of £5 per night for the UK, and £10 per night outside of the UK, employees simply claim their expenses and then add a further £5 to their claim without the production of evidence of any cost actually being incurred.
- 6.12 This seems to be an approach used by many employers and in some cases it is, mistakenly, considered to be HMRC policy. This seems to suggest significant confusion amongst employees, employers and some HMRC staff about the true nature of scale rates and other seemingly fixed allowances. It also points to a need to tighten up the guidance on such practices.

⁴ <https://www.gov.uk/government/news/tribunal-holds-recruiter-to-account-for-temps-tax-bill>

- 6.13 AAT considers that if such confusion exists now, there is a danger that under any new process the situation could deteriorate.
- 6.14 We consider that scale rates are critical to the efficient and effective management and administration of employee expenses reimbursement and we feel both the standard scale rates as laid down by HMRC and the ability to apply for a custom rate should remain.
- 6.15 We are aware of anecdotal stories of employees claiming an overnight allowance (inclusive of meals and overnight accommodation) in instances where they bring their own food and sleep in their vehicle. Assuming such practices occur, which seems likely, HMRC will have to be mindful of such practices when designing any underpinning compliance regime.

Question 4: Are there any examples of particular industries or types of employer who would be affected if custom scale rates could not be used with the proposed exemption? What would the impact be on those employers?

- 6.16 AAT considers there is a clear need for custom subsistence rates even though very few employers currently make use of them.
- 6.17 We would anticipate employers in the oil and gas exploration sector use custom rates and consider it appropriate for them to continue with their current practice unless HMRC consults with employers in the industry to design standards appropriate to their sector.
- 6.18 AAT believes there is a clear need for a new streamline, but robust, approval process by which custom rates can be applied for.

Question 5: Would employers be disadvantaged if a process to apply for custom scale rates were not retained? If such a process were retained, would it be seen as additional complexity by those employers who do not need it?

- 6.19 AAT is of the opinion employers would welcome the removal of the process of applying for custom scale rates, as employers are likely to prefer a much simpler process which is suggested by the fact that only 1% of new applications request a custom rate (5.7, condoc).

Question 6: Would employers welcome the ability to self-certify the sampling exercise undertaken to support a custom scale rate? If so, would a sampling process set out in guidance or regulations provide sufficient certainty for employers that wish to use a custom scale rate?

- 6.20 AAT considers employers would welcome the ability to self-certify their compliance and see it as a positive reduction in the administration burden. In many other areas of PAYE employers are effectively already self-certifying aspects of their compliance.
- 6.21 In many aspects of the UK tax system, taxpayers, already, self-certify their liability for example in respect of income tax and NIC. It seems to us that it would be appropriate to extend the process of self-certification to custom scale rates.
- 6.22 In order for a self-certifying process to work in this area employers will need to know that their work, supporting evidence, sampling and future payments can at any time be subjected to a review and even a face-to-face compliance check. They should know that a review could come from PAYE compliance, VAT or corporation tax requirements.
- 6.23 A parallel could be drawn with the existing expenses reimbursement process which does not need to be approved by HMRC. Employers only need to submit a copy of their policy and examples of claims processes, and in some cases not even that.
- 6.24 In giving our approval to the concept of a self-certification process we recognise that there is no guarantee that the employer and employee will maintain the integrity of their checking process over time. As a counterbalance we advocate that a compliance checking process is maintained.

Question 7: What are the reasons for one person companies and very small, close companies paying scale rates to directors in respect of expenses? Would such employers be disadvantaged if they were not permitted to pay scale rates to their directors under the proposed exemption? If so in what way?

- 6.25 AAT considers there to be little reason for a one-person company to pay scale rates, on the basis that the scope for achieving administrative efficiencies is limited. However, we are aware that many one-person and close companies have negotiated dispensation agreements because they can show extensive record keeping discipline is in place, even if there is technically no independent checking of claims.
- 6.26 While in general AAT is not persuaded that there is a wholesale requirement for one-person companies to pay scale rates we do not believe that such companies should be precluded from making such payments if they can prove that it is a suitable practice for them to adopt and is more efficient and effective for themselves and HMRC.

- 6.27 AAT would not be supportive of any move which arbitrarily removes the facility without a consequent ability to allow this practice in suitable cases.
- 6.28 In responding to question 7 we have commented on the overarching principle and at the same time decline to give specific examples.

Question 8: Would employers welcome being able to continue to rely on their existing dispensation for a transitional period, or would this be a source of unnecessary complexity? If so, how long would the transitional period need to be to be useful?

- 6.29 We consider that there is little doubt that employers draw comfort from the fact that they hold a dispensation. However, if the dispensation process is replaced by a statutory exemption for genuine business expenses then we cannot see any real benefit in retaining dispensations for a transitional period.
- 6.30 As observed at 6.4 (conduc), some employers may find themselves trying to manage two systems and as a consequence we would favour the removal of dispensation agreements upon the implementation of a statutory exemption.

Question 9: Independently of whether existing dispensations may continue to be used, would employers welcome being able to continue to use any custom scale rates they had agreed as part of their dispensation for a transitional period? If so, how long would the transitional period need to be to be useful?

- 6.31 AAT believes very strongly that employers with extant custom-rate agreements, whether that is within an existing dispensation or otherwise, should be permitted to continue using that rate until the conditions which led to the application and approval are no longer valid.
- 6.32 As stated in 6.14 (above), if a custom scale rate is used for administrative efficiency and HMRC will have agreed with that reason then it should not be removed simply because of the introduction of a different way of processing employee expenses.
- 6.33 Upon implementation of the new proposal to remove dispensations, AAT for the reasons outlined in 6.31 – 6.32 does not support the removal of custom-scale rates.

- 6.34 However, during a transitional period after implementation of say one tax year we would suggest that employers who have custom scale rates be required to restate their case for why they should be able to continue to apply the custom scale rates.

Question 10: Are there any specific situations or circumstances in which employers would not feel confident paying expenses because of a lack of clarity in HMRC's guidance? Which changes could HMRC make to its guidance that would have the biggest impact on employers' confidence in paying these expenses?

- 6.35 AAT members report that the most confusing areas of the expenses system are contained within booklets 480, Expenses and benefits – a tax guide, and 490, Employee travel – a tax and national insurance guide, and the triangular travel rules and those for evidence.
- 6.36 With the triangular rules employers find themselves confused by the comparison between the HMRC definition of a business journey and the one they use in their terms and conditions of employment.
- 6.37 The public sector habitually uses the “greater than” rule for reimbursing travel costs and most public sector bodies apply it diligently as it provides adequate reimbursement for employees and is generally perceived to be fair by taxpayers.
- 6.38 Many private sector businesses use the same rule for cost effectiveness whereas others mirror the HMRC rule for tax free travel in order to streamline their administration, even if it means over-compensating employees for business travel.
- 6.39 While the guidance in the HMRC booklet 490 is good and informative it is too expansive. There is a proliferation of examples; some appear to contradict the general rule. One member reported that a client used the full journey rule “because the HMRC booklet says I must”.
- 6.40 AAT believes the guidance could be simpler to use, particularly by small employers who do not have time to examine the rules in detail.
- 6.41 Businesses are often confused over the requirement to keep evidence of the employee incurring a cost before they can justify the reimbursement of the expense and this leads to a variety of approaches.

- 6.42 While the guidance in both booklets is, to us, clear and unambiguous, when an employer compares it to VAT record keeping rules they find the burden of proof is different and in some cases no proof is needed, such as with the under £25 gross cost rule. For costs up to and including £250 gross a simplified form of proof is all that is required to legitimise the input tax reclaim.
- 6.43 The issue outlined in 6.42 (above) is compounded by the fact that an incorporated employer will be faced with different rules, again in respect of corporation tax.
- 6.44 We recommend HMRC, as part of the review process, should take the opportunity to standardise the requirement to retain evidence across the heads of duty and to make the guidance simpler for employers.
- 6.45 Taking into account online technology permits guidance to be laid out at a high level with the facility to drill down to greater detail for those employers who need it, AAT believes this principle should be used for examples, with perhaps a facility to seek out those examples which meet the employer's criteria, enabling irrelevant examples to be filtered out.

Question 11: Would employers and other affected parties welcome the exemption not coming into force for a period of time after the legislation is in place? If so, how long would employers and other affected groups need to prepare for the new exemption coming into force?

- 6.46 AAT welcomes the comment in paragraph 6.17 (condoc) that the idea of implementing the new scheme on 6 April 2015 will not be pursued. We consider implementation on that date would be too early as it would not afford HMRC, or employers, sufficient time to prepare and have any new processes, procedures and policies in place.
- 6.47 Similarly, we welcome the rejection of a phased implementation (6.19, condoc).
- 6.48 It is our view that full implementation on 6 April 2016, or 2017 if the proposed legislative changes come into effect on 6 April 2015, would be appropriate.
- 6.49 We consider that implementation could prove to be more problematic for the smallest employers, despite the views expressed at 6.18 (condoc). However, given an appropriate suitable lead time tax and payroll agents will be able to educate their clients in respect of the new process.

Question 12: How should dispensation applications that are made in the intervening period be handled?

- 6.50 In the lead up to the implementation of a simplified exemption all dispensation applications should be processed in the normal way.
- 6.51 However, employers should be advised that their dispensation will only be valid until the exemption comes into force.
- 6.64 As a transitional measure, we suggest, applications for new dispensations submitted less than a complete tax year before the new exemption should be rejected and employers instructed to use the new exemption.

7 CONCLUSION

- 7.1 AAT welcomes the opportunity to debate this matter fully and openly and along with the related benefit in kind consultations it is an area that will benefit from review.
- 7.2 The administration and management of employee expenses and benefits in kind is a relatively straightforward task for most employers. The rules for reimbursement of expenses incurred by employees are generally applied from good accounting and auditing principles first with adherence to income tax and national insurance principles second.
- 7.3 Employers who follow the guidance of their accountants and payroll advisers tend to have good, robust claims management procedures.
- 7.4 Past experience of major changes to taxation legislation leads AAT to believe that the adoption of all aspects of the proposed new exemption would be highly beneficial to employers.
- 7.5 AAT considers that a single implementation date of April 2016 or 2017 is the most appropriate, as all employers will be working to the same set of rules at the same time, as we previously recommended in 6.48 (above).
- 7.6 AAT has been advocating the self-certification of dispensations (5.2, above) for many years because those employers who comply with the rules often find themselves non-compliant simply because they have not been managing their dispensation properly. We believe that compliance with the rules is important.
- 7.7 We therefore welcome the proposal to move away from dispensations to get back to promoting compliance with the rules. However, more work is needed on the guidance in support of this move.

8 ABOUT THE AAT

- 8.1 AAT is a professional accountancy body with over 49,600 full and fellow members and 74,000 student and affiliate members worldwide. Of the full and fellow members, there are 4,000 Members in Practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types. (Figures correct as at 30 June 2014).
- 8.2 AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.
- 8.3 In pursuance of those objectives AAT provides a membership body. We are participating in this consultation not only on behalf of our membership but also from the wider public benefit perspective of achieving sound and effective administration of taxes.
- 8.4 Thank you for the opportunity to respond to the HMRC consultation document on “Employee Benefits and Expenses – exemption for paid or reimbursed expenses”.

Further engagement

If you have any questions arising from our submission or would like to discuss any of the points in more detail then please contact the AAT at:

email: consultation@aat.org.uk and aat@palmerco.co.uk

telephone: 020 7397 3088

Aleem Islan

Association of Accounting Technicians

140 Aldersgate Street

London

EC1A 4HY