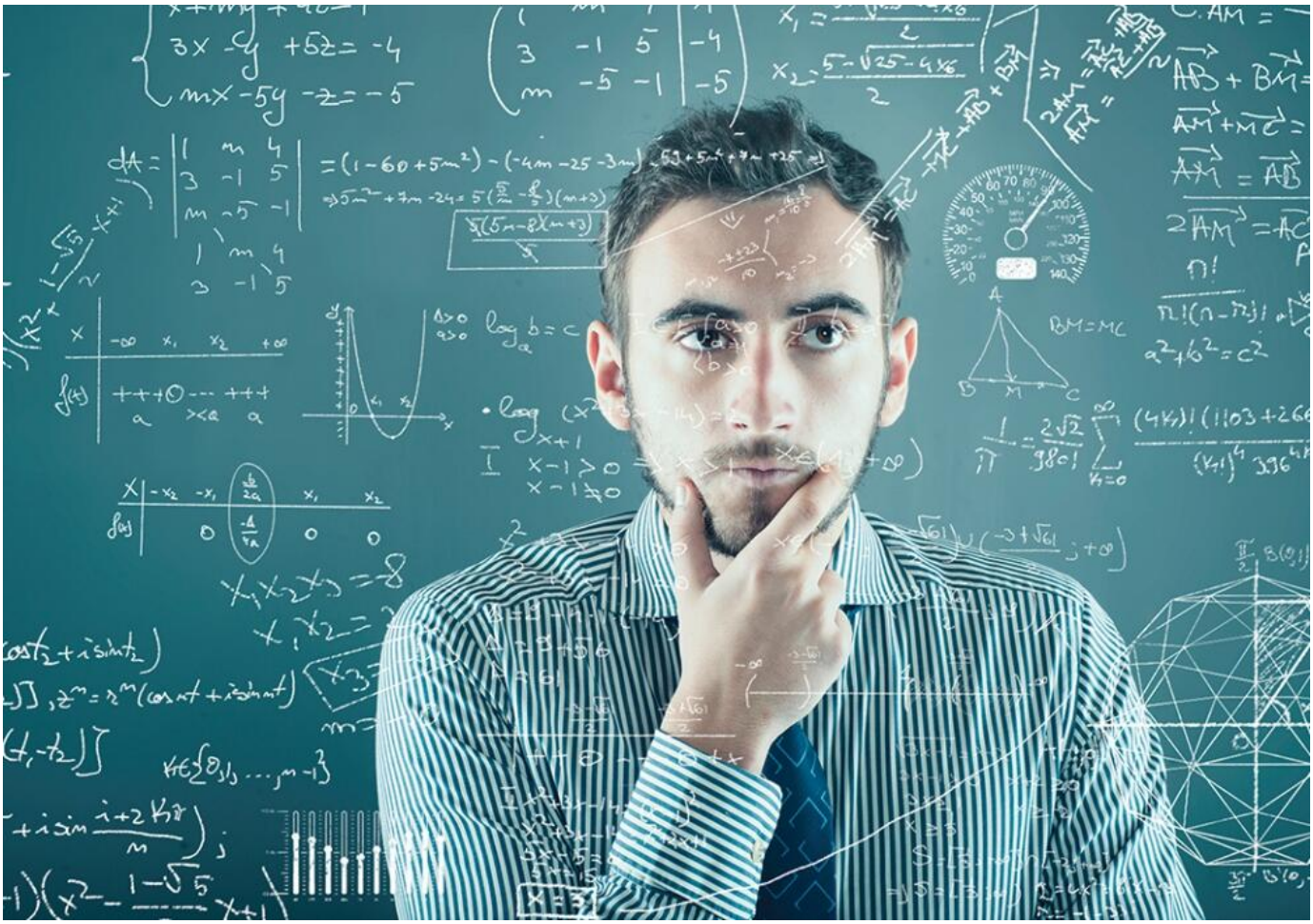
# Easy to understand?

Employment Tax



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*Andrew Brookes* asks why so many businesses fall foul of the rules for the National Minimum Wage and the National Living Wage

The National Minimum Wage and the more recently introduced National Living Wage should be simple to understand and to apply, so why do so many businesses fall foul of the rules?

This article will set out the key points that employers need to understand, point out common causes of non-compliance and highlight recent changes. For ease, both the National Minimum Wage and the National Living Wage will be referred to collectively

as NMW for the remainder of the article.

The premise of the regulations is simple. The government publishes minimum rates of hourly pay that employees must be paid for each hour of work they do. Businesses know the hours worked by employees and the rate of NMW applicable, and they pay at least the relevant NMW rate for all worked hours. What can possibly go wrong?

Sadly, the answer is plenty! Obviously, some employers deliberately underpay their employees and these employers are at risk of serious consequences. However, this article is not aimed at the deliberate defaulters; it is aimed at employers that have no intention of underpaying employees but for whom NMW is sometimes not on the radar until it is too late, and at their professional advisers.

If the premise of the legislation is simple, then why do accountants need to worry about NMW compliance for their reputable clients? The main reason is that the legislation and its application is far from simple. This complexity is the combination of two factors:

- Firstly, the rules need to apply to all the wide-ranging arrangements that employers have for engaging their employees.
- Secondly, anti-avoidance protection is built in to prevent businesses from manipulating the arrangements to reduce pay to the employee. These combine to lay traps for the unsuspecting.

## The consequences of errors

The consequences of getting NMW payments wrong can be extremely expensive and damaging for a business, consisting of:

1. making good underpayments to employees at the current NMW rate;
2. penalties of 200% of the unpaid wages (cap of Â£20,000 per employee but no overall limit); and
3. public naming and shaming.

The magnitude of settlements can have a significant effect on adviser/client relationships, as well as potential implications for audit reporting.

## Where do businesses go wrong?

Ignoring the deliberate defaulters, the main reasons for non-compliance fall within the following areas:

- identifying the 'pay period';
- determining the working hours for NMW purposes;
- paying the right rate based on the employee's age;
- apprentices;
- provision of accommodation;
- clothing and equipment charges; and
- other charges to employees.

## Pay period

A crucial step that is often overlooked is identifying the pay period. This is important because NMW payments apply to each pay period in isolation and the rules covering payments considered for the test differ based on the category of employee. You must know the pay period so you can ensure that the pay for that period is at least equal to the NMW obligation for that period. A pay period is a maximum of one month but is often shorter.

The main reason that businesses fall foul of this obligation is because they wrongly assume that the employee is classed as a salaried employee, with the assumption that if NMW is satisfied over the whole year on average then this is all that is required.

In order to be classed as a salaried worker, for NMW purposes certain conditions must be satisfied; and if they are not, the employee is not treated as salaried. If not salaried workers, the employee will be a worker undertaking time work, output (or piece) work or unmeasured work.

## Type of work

### 1. Salaried work

All the following conditions must apply for an employee to be treated as performing salaried hours for NMW purposes:

- They are paid under their contract for an ascertainable basic number of hours per year (the basic hours).

- They are entitled to an annual salary for those hours.
- They are entitled to no other payment for the ascertainable basic hours except a performance bonus and/or (from 6 April 2020) a salary premium.
- They are paid either in equal instalments which are:
    - monthly;
    - weekly;
    - two-weekly (from 6 April 2020);
    - four-weekly (from 6 April 2020);
    - other equal periods between a week and a month (from 6 April 2020); or
    - they are paid in varying monthly instalments resulting in the worker being entitled to be paid in equal amounts each quarter (from 6 April 2020).

If the conditions for salaried hours work are satisfied, it does not matter how many hours the worker works in a week, month or other period; whether all the basic annual hours are working hours; and whether the worker works extra hours in addition to the basic annual hours for which he receives his annual salary.

Salaried hours work can include workers who only work part of the year, such as term time workers, as long as they are paid in equal payments as described above throughout the year and the other conditions are satisfied. The recent changes will also benefit the retail industry, where many workers are paid hourly or per day and so have varying pay between periods.

**2. Time work**

This is work, other than salaried hours work, in respect of which a worker is entitled under their contract to be paid. There are three circumstances when work is time work:

1. The worker is paid under his contract solely according to the length of time worked.
2. The worker is paid under a contract according to the level of output over a certain period of time, e.g. an hour; and the worker is required to work for a set period of time, e.g. a piece worker in a factory. While being paid according to output per hour, he is regarded as doing 'time work' for NMW purposes because of the requirement to work for a set period each day.
3. A worker working in the circumstances of point 2 above is paid by the hour because he fails to reach the level of output per hour set by his contract. For example, a piece worker required to work for seven hours per day and produce

five widgets per hour would normally be paid per widget. However, if he produces fewer than 35 widgets, he must still be paid for the full seven hours work at NMW rate.

A worker will be regarded as doing time work if pay relates to the amount of time worked, but they do not meet all the conditions to be regarded as salaried. This includes those who perform piece work with set hours; who are paid commission only with set hours; and who are simply paid for set hours.

For time workers, while the employer can pay based on productivity, the employer must ensure that they either agree a fair piece rate, using the rated output work system, or that the pay also meets the NMW for the time worked.

**3. Output work**

This is simply described in the regulations as not time work. Pay is based on the number of widgets or another measure (e.g. value of transactions). For example, such workers might be telesales staff, without set hours. The key differential from time work is that there is no set number of hours for output workers.

**4. Unmeasured work**

This is a 'catch all' for anyone that does not fall within the first three categories. These workers have no fixed hours but could still be paid based on the actual hours worked.

## NMW working hours

For some employees this is very straightforward, as they work fixed hours at a single location; errors should be rare. The problems generally arise when either the location of the work changes, or the employer imposes obligations on the employees outside of the core time.

For travelling employees, the circumstances are key to determining the working hours. It will often be the case that these employees require payment for all time from starting work until they finish working, with the possible exception of a lunch break. This period could include travel time, waiting time and break time, as well as actual work performing time. There can be exceptions, but the starting point should be to consider the total length of the working day and then to consider what time, if

any, the regulations will allow to be excluded from the calculations.

There can also be employer-imposed obligations at the start or end of the day. These could, for example, be clocking-in systems or security checks. Where these take place outside of normal working hours, the time spent waiting for and undertaking these tasks is 'working time' for NMW purposes. A five hour shift with a further 30 minutes for clocking on and security check time makes the shift length for NMW purposes five and a half hours.

## Rate of NMW

Ignoring apprentices, there are set NMW rates that apply based on the age of the employee. Care is required to ensure that higher rates are applied as soon as applicable. For all employees, the rates change annually on 1 April (previously 1 October). This is not often overlooked because there is publicity around the change and it is expected.

The timing that can cause problems is birthdays; a birthday does not always trigger a change, but sometimes it does. If the business does not have adequate systems in place alerting it to the possibility of an increase in NMW rate, it can be missed resulting in non-compliance.

## Apprentices

A significant percentage of the NMW defaults relate to apprentices because they add complications to the working hour and rate of pay issues.

The first trap is applying the reduced apprentice rate inappropriately. This reduced rate only applies to apprentices aged under 19 and to those aged over 19 but still in the first year of their apprenticeship. All other apprentices must be paid the full NMW rate based on their age.

The reduced apprentice rate is only applicable for those on approved apprenticeships, but some employers mistakenly apply it to apprentices that are not on an approved scheme who are entitled to the normal NMW rates.

The other common issue is failing to appreciate that training time is working time and that the apprentice must be paid at their NMW rate while training or attending college, in addition to working time.

## Accommodation

Employers providing employees with accommodation are entitled to charge the employee for that accommodation. However, the amount of the charge in the NMW calculation is capped at £57.40 per week or £8.20 per day from April 2020. This charge includes services such as gas, electricity, laundry, etc., as well as furniture provided by the employer. The potential to recharge costs to employees is extremely limited and the cost to the employer of providing accommodation will often exceed the permitted reduction in pay. Consequently, in addition to increasing the possibility of NMW default, providing accommodation is often commercially undesirable.

## Clothing

The NMW problems caused by clothing can be both direct and indirect. The direct clothing charge applies where an employer supplies the employee with clothing for work and applies a charge to the employee for this. If the pay was at NMW level before the clothing charge, the charge will cause a default.

Where the business imposes a dress requirement on the employee, e.g. a requirement to wear black shoes, this is an indirect cost that needs to be considered when calculating NMW. Again, paying at NMW level before considering the cost of the shoes will result in an NMW default.

## Other charges

Care is required with other costs charged to employees, with any compulsory charges likely to cause an NMW default for those paid at or close to NMW before the charge is imposed; for example, an employee charged for a company provided mobile phone so they can perform their employment responsibilities.

## Summary of recent changes

### Salaried workers

As mentioned above, this category has been widened to include additional pay periods. This will be welcome news to businesses discovering that their previous arrangements did not meet the conditions of salaried workers for NMW purposes.

### Salary premium

With effect from 6 April 2020, employers must ignore some premium payments for basic hours to workers performing salaried hours work for minimum wage purposes. These are payments for working:

- at certain times of the day;
- on a particular day (e.g. enhanced pay for public holidays);
- at a location;
- within a particular environment;
- on a particular task; and
- subject to a particular responsibility.

This enables employees to receive incentive or enhancement payments for some hours without falling outside of the salaried worker category.

### Salary sacrifice

The NMW system has long been criticised for denying lower paid workers the opportunity of benefiting from salary sacrifice arrangements. This has now been addressed with the government deciding that employers offering salary sacrifice schemes will no longer be subject to financial penalties if the scheme brings payment below the NMW rate, providing strict conditions are met, including a requirement for the employee to willingly opt into the scheme. Charges for the provision of work clothing, equipment, etc. are outside of this concession.

### Public naming and shaming

This is to be reintroduced with a small concession. The default limit to trigger naming and shaming is increased from Â£100 to Â£500. While this is a five-fold increase, it is unlikely that defaults will be below the new limit and all offenders are likely to be publicly identified as defaulters.

### Additional support from HMRC

HMRC is to provide additional resources to help businesses comply with the regulations.

## Conclusion

The HMRC budget for tackling NMW compliance has been more than doubled recently, demonstrating that HMRC is taking its enforcement responsibilities seriously. This article shows how easy it is to fall on the wrong side of the NMW line. Care is essential to ensure you understand the hours that must be paid for, the category of worker, the pay that can be considered and the reductions that must be made to pay in determining whether NMW compliance is achieved. Caution is especially recommended before any conditions are imposed on, or charges are made to, employees.

## CHANGES TO RATES

NMW top rate being equivalent to 60% of median earnings. The new rates are:

| | Previous rate | Current rate (from 1 April 2020) | Increase |
|---|---|---|---|
| National Living Wage | £8.21 | £8.72 | 6.2% |
| 21-24 Year Old Rate | £7.70 | £8.20 | 6.5% |
| 18-20 Year Old Rate | £6.15 | £6.45 | 4.9% |
| 16-17 Year Old Rate | £4.35 | £4.55 | 4.6% |
| Apprentice Rate | £3.90 | £4.15 | 6.4% |
| Accommodation Offset | £7.55 | £8.20 | 6.4% |