One step further

Employment Tax



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Stephanie Symonds-Dye looks at the advantages and limitations of payrolling benefits

Key Points

What is the issue?

HMRC have introduced for the first time a legal framework to support employers who wish to payroll employee benefits in kind.

What does it mean to me?

Employers can withhold the taxes due on employee benefits via PAYE, creating more certainty for the employee and possibly less year end administration for the employer.

What can I take away?

Employers should consider if they are appropriately resourced and equipped to manage the payrolling process. Interested employers must register with HMRC via the online ‘Payrolling Benefit in Kind’ service before 6 April 2017, to begin payrolling benefits in 2017/18.

From 2016/17 onwards, employers can formally register with HMRC to payroll benefits in kind. Although the option to payroll benefits has been available to employers in the past, this has traditionally been agreed with HMRC on an ad-hoc basis, often resulting in a lack of transparency for other employers considering this option.

FA 2015 introduced for the first time a legal framework governing the voluntary payrolling of benefits. The new law (and accompanying HMRC guidance) has provided greater clarity to employers who are considering payrolling benefits, and with this HMRC have established a dedicated team to support employers through this process.

Registration

Prior to payrolling, employers must register with HMRC using the online Payrolling Benefits in Kind service. The next opportunity employers may now begin formal payrolling is 6 April 2017, and registration for the 2017/18 tax year must happen prior to 6 April 2017. When registering, employers will need to outline to HMRC

which individual benefits they intend on payrolling, and HMRC will agree this on a benefit by benefit basis.

Once registered, employers must payroll the agreed benefits on an on-going basis and there is no need to re-register each year. If employers wish to cease payrolling benefits, the earliest they may do so is the start of the next tax year, by formally de-registering. If payrolling ceases part way through the tax year without HMRC's approval, the employer could be liable to PAYE penalties for incorrect returns unless specific circumstances apply, as outlined below.

Once HMRC receive the employer's registration, tax codes will be updated to remove the benefits in question and the employee will in most instances be put on a regular tax code. I have seen this happen very quickly in practice, making this part of the processes smoother than originally feared.

Advantages of payrolling

The requirement to complete a P11D (non-cash benefits form) disappears if the employee's benefits are being payrolled. This removes the risk of P11D penalties for incorrect or late submissions, but it is replaced by the risk of PAYE penalties should the employer operate the payrolling process incorrectly. This perceived administration benefit to the employer is tempered somewhat by the fact that it will still be necessary to complete a form P11D(b) to report benefits for Class 1A National Insurance purposes.

Furthermore, by payrolling benefits on a real time basis employees will be more likely to pay the correct tax due on their benefits each month via PAYE. Whilst this gives employees slightly more comfort that there will be no surprise liabilities, from a cash flow perspective it does mean the employees are paying tax sooner than they have done in the past. In the first year that benefits are payrolled there may be cases where the employee is effectively paying tax on two years worth of benefits in one go, where a prior year underpayment is included in their tax code. Therefore, employers should consider this when communicating any changes to their employees.

Limitations

There are still certain benefits which cannot currently be payrolled, including;

- Vouchers and credit tokens
- Employer provided living accommodation
- Interest free and low interest (beneficial) loans

If an employee receives any of the above benefits a P11D must be completed and submitted to HMRC by 6 July as usual. Employers that offer the above benefits as standard should consider if payrolling is right for them, as the advantage of doing so is clearly reduced if a P11D is required anyway. It is worth noting that non-cash vouchers and credit tokens are expected to be eligible for payrolling from 6 April 2017.

Employers cannot remove an employee from payrolling mid way through the tax year unless the below specific circumstances apply:

- There is insufficient income to cover the tax on their benefit (i.e. the 50% withholding rule); or
- The employer stops paying the employee.

The 50% withholding rule is important here. The PAYE regulations prevent employers from deducting more than 50% tax from an employee's cash pay in most cases, to ensure employees are left with enough cash each month to cover their essentials. If an employee's cash pay is reduced significantly, but their benefit entitlement continues (for example, when an employee goes on maternity leave) employers may come up against this rule.

In the event of this, employers are allowed to temporarily stop payrolling benefits until cash pay has increased back to a sufficient level however, if this is not expected to happen in the short term, employers may request that the benefit be re-introduced into the employee's tax code. It's important here for employers to decide how they will treat these exception cases ahead of registering.

Payroll processing

The employer must calculate the annual cash equivalent of the benefit in the same way as under the P11D process–the difference here is the timing. Under the P11D process, the employer has the benefit of hindsight, and can calculate the value of the benefit once the tax year has closed.

However for payrolling purposes, the benefit must be calculated up front on an estimated basis for the tax year and should then be monitored on a regular basis to ensure the aggregate value entered into the payroll each pay cycle is correct at the end of the tax year.
Once the cash equivalent of the benefit has been calculated, the employer should divide this equally between the total pay runs in the tax year. So if employees are paid monthly, the annual cash equivalent will be divided over 12 and so on. For employers with relatively mainstream benefits this should not be too problematic. However, for some, this may prove difficult. For this to work successfully, payroll teams must be closely aligned to their tax counterparts, to ensure any updates or revisions to an individual's benefits are re-calculated on a real time basis as appropriate. Additional staff training and advisor costs may be required to enable this so employers should factor this in when considering their options.

Consideration around the timing of the employer's benefit cycle must also be made. For example, if the employer renews their annual health care contract on 1 January every year, the cash equivalent of this benefit will likely change on this date. This means, from January onwards the employer needs to recalculate the cash equivalent in light of their newly negotiated healthcare contract, and reflect the revised benefit value in January's pay run and thereafter.

It is critical that payroll teams are well equipped to understand when the cash equivalent has changed and by how much. Strictly HMRC are able to impose PAYE penalties if employers do not get this right on a real time basis, however HMRC have suggested an estimate can be made at the start of the year if the cash equivalent is not yet known. This pragmatic approach is welcome.

Employee communications

Once the employer has registered to payroll benefits, they must write to their employees to let them know what payrolling is, how it works and what it means for them. Helpful template letters are available within HMRC's online guidance however, the use of these templates are not mandatory so employers can be flexible around the way they communicate this change to their staff.

Employers must also provide employees with a statement containing a description of the benefits they've received during the tax year, and the cash equivalent value, by

1 June following the end of the tax year in question. This may be seen as partially offsetting the administrative benefit of not having to prepare a form P11D.

Other considerations

The way National Insurance is calculated and collected on benefits in kind has not changed. Class 1A National Insurance will still be payable by 22 July following the end of the tax year, and a P11D(b) will be required to report the cash equivalents to HMRC by 6 July (even if these benefits have been payrolled).

Also, importantly, employers must be confident that their payroll software can cope with such a change. For payroll purposes, the benefit amount will be considered a ‘notional’ non-pay item, subject to tax only, which for some employers may be unusual. Several major payroll providers have announced they will be able to support the payrolling of benefits from 6 April 2017, suggesting an expectation that this will become an increasingly popular option for employers.

Finally, with HMRC’s increasing focus on ensuring employers have appropriate tax accounting arrangements (particularly around employment tax matters) it is worth noting that payrolling benefits brings those benefits into the remit of the Senior Accounting Officer (SAO) rules. Therefore, if an employer falls into this regime, they should consider whether the appropriate accounting arrangements are in place before registering with HMRC.

Conclusions

Payrolling benefits is one step further towards tax simplification and part of HMRC’s drive to collect information and tax from employees on a real time basis.

Although there is considerable administration required during the year to ensure the operation of the payroll is correct, employers can as a result enjoy a slightly reduced compliance burden at year end. Whilst this is currently a voluntary arrangement, it isn’t difficult to foresee a time soon when this will become mandatory practice.