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01 July 2017

Kym Hanbridge and *Eleanor Meredith* provide guidance on the challenges faced by firms dealing with the UK apprenticeship levy

Key Points

What is the issue?

Most employers with an annual pay bill in excess of £3 million are now paying the apprenticeship levy. Even calculating the amounts due may be challenging in more complex situations where groups of companies are involved or part of the employee population is outside the UK National Insurance charge.

What does it mean to me?

For many employers the conditions that have to be met in order to access apprenticeship levy funding are so restrictive that they will regard the levy as a cost

they can never recover. Review of your existing learning and development platforms to assess suitability for funding and also proposals for potential transfers of funding in the future may help to alleviate this.

What can I take away?

The levy is not as straightforward as it first appears, especially for employers with parts of their business in Scotland, Wales and Northern Ireland as apprenticeship funding is a devolved matter. Completing employees' home addresses in the payroll may become more important than it has been in the past, as in most cases it is the employees' home addresses that will drive any allocation between the different countries of the UK.

From 6 April 2017 employers in the UK with a pay bill of more than £3 million per annum are charged a 0.5% apprenticeship levy which is collected via the PAYE system and paid to HMRC who (in England at least) then credit the payments to the employer's Digital Apprenticeship Services (DAS) account. The funds in the DAS account can be used to fund apprenticeship training for their employees.

As is often the case with new law, the basic premise is deceptively simple and the devil is in the detail of the law's application, especially in cases that are less than straightforward. This article considers the application of the law in some of the more complicated circumstances that employers tend to encounter, together with some of the difficulties so far encountered.

Legislative framework

The apprenticeship levy law was introduced by Part 6 of Finance Act 2016 and supported by amendments made by SI 2017/414 to the PAYE Regulations (SI 2003/2682). Together these set out a framework for the calculation, reporting, payment and recovery of the apprenticeship levy. HMRC has issued guidance to employers via the April 2017 Employer Bulletin and on the gov.uk website. It has also released internal guidance intended primarily to support its own staff in the Apprenticeship Levy Manual.

Some of the core definitions need a little more commentary. The employer's pay bill is defined by FA 2016 s 100 as the amount on which the employer has a secondary

Class 1 NI liability. This in itself is not always straightforward to calculate, especially where expatriate employees are involved and modified PAYE is applied to calculate tax on an estimated basis. Some of the difficulties associated with this are considered in more detail below. Even in a domestic law context the calculation has its own set of elephant traps, as the employer's pay bill includes all pay that is liable to secondary NI, including amounts under the lower earnings limit and anything chargeable at a zero rate. So amounts paid to apprentices and those under 21 are liable to the levy because they are strictly liable to NI, even though in practice an employer will not pay any secondary NI on them, because a zero NI rate is applied.

The £3 million de minimis is achieved by means of a levy allowance of £15,000 per employer or group of connected employers. Additional rules apply to charities that are connected with each other or to other companies. In broad terms, companies will be connected if one has control of the other or if the same person has control of both. An obvious example will be groups of companies in common ownership, but the law goes further than requiring those that may be connected to consider voting rights; substantial commercial interdependence can also tip the balance. Charities will generally be connected with companies that they control or with other charities where more than half of the trustees of one charity are also trustees of the other.

Where an employer is connected to another the level of levy allowance is £15,000 taken across all the connected parties. The connection test is applied at the start of the tax year, so that if a company acquires another during the tax year, although they become connected, in principle each may be entitled to a full £15,000 allowance for that tax year. Assuming that the new subsidiary remains a subsidiary at the start of the following tax year, there will be at least two connected companies to consider for the purpose of claiming the allowance in year 2.

The position is very different, though, where a company simply purchases another's trade and assets and transfers employees under TUPE. Although the outcome is similar in terms of where the employees and business end up, for the purposes of the levy allowance only the company which is taking on the business and employees can have any entitlement.

How does the levy allowance work in practice?

Employers need to notify HMRC of a liability to pay the apprenticeship levy if their pay bill in the previous tax year exceeded £3 million or they consider that their pay

bill will exceed the £3 million threshold in the current tax year. Therefore, the test has to be considered at the start of the year, so that employers who know they are liable then register with HMRC, but should also be kept under review throughout the year by employers who may exceed the threshold later on. They also need to ensure that they consider the less obvious elements (amounts below the lower earnings limit and payments to apprentices, as noted above for example), in calculating which side of the threshold they fall.

Practically, connected employers or employers operating multiple payrolls will need to aggregate their pay bill to determine whether they exceed the threshold, although strictly the Regulations require them to consider their share of the levy allowance (T) compared to their own anticipated or previous year's pay bill.

The share of the levy allowance 'T' is determined by the members of a charity or company unit at the start of the tax year, but they have a free choice over the allocation. Deciding how much to claim on any payroll is more than an academic exercise, since any split decided on is returned to HMRC with the first RTI return of the tax year and will remain in force over the remainder of the tax year and cannot be amended by the employer. If the allowance claimed across the whole unit is not £15,000 by the end of the tax year, HMRC has to determine the correct figures, dividing the £15,000 between the unit members, based on the proportion of the total levy previously claimed that was allocated to each.

To take a very simple example, if there are two companies in a group and they had intended to allocate the levy evenly between them, but one claimed the full £15,000 in error, that company would be allocated £15,000/(£15,000 + £7,500) x £15,000 = £10,000 with the other company receiving £5,000 of allowance only. So the proportion in which any levy is claimed across a group cannot subsequently be amended. The monthly levy allowance is calculated on a cumulative monthly basis so that if a particular employer has an irregular pay bill, perhaps because of annual bonuses or quarterly commission payments, it is possible to use up levy allowance not fully utilised in the earlier months later in the tax year.

For companies with many employers in the same group, the simplest solution may be to allocate the levy allowance to a single employer in the group, which it is clear will have a pay bill in excess of £3 million. Any need to share the allowance could be addressed by means of internal recharges, without introducing any additional complexity into figures returned to HMRC. This may also help to reduce the risk of

inadvertently excessive claims if all group companies otherwise claim a share.

Although the £15,000 allowance is sufficient to take a significant number of employers outside the scope of the levy it has evolved to complex and lengthy law, being covered in detail in Finance Act 2016 and in the updated PAYE Regulations. This complexity is the result of lobbying mainly from smaller groups that the original simple allocation proposed wouldn't have worked in some cases – and the acceptance by the government that a more complicated mechanism was needed to deliver a fair solution. As a further consequence, the law includes an anti-avoidance rule that withdraws any entitlement to the levy allowance if there are any arrangements which have as their main purpose (or one of their main purposes) obtaining any benefit or further benefit from an entitlement to a levy allowance, or otherwise obtaining an advantage in relation to the apprenticeship levy. This feels excessive for the relatively modest amounts involved, although HMRC and the government will no doubt have had in mind significant attempts to enhance claims for the £3,000 employment allowance.

What happens with expatriate employees?

In the simplest situation, expatriate employees assigned to the UK from countries with which the UK has a social security agreement will remain within their home social security regime and be exempt from UK NI. In these circumstances, no secondary Class 1 charge will apply to the employer and the employees' earnings will not be part of the employer's pay bill for the purposes of calculating the apprenticeship levy. For those from non-agreement countries, no NI liability will apply for the first 52 weeks of any UK assignment and so those employees' earnings will also be outside the scope of the apprenticeship levy for that period.

Given that these individuals will typically be in the UK for a relatively short period to fulfil a specific employer need there is a certain logic in excluding their earnings from funds used to calculate the funding for UK apprenticeships. However, those who come to the UK to work on a local contract are not differentiated from other local hire employees in any way. So if, for example, an employer agrees assignment terms for employees needed for specific business projects, but uses local to local transfers for any assignments undertaken at the employee's own request, care will be needed to identify the appropriate population to whom the levy should be applied.

What is the impact of modified PAYE?

For tax equalised populations where the employer has entered into a specific agreement, HMRC allows a relaxation of accurate PAYE withholdings and instead allows employers to operate PAYE on an estimated basis using modified PAYE. Modified NIC withholdings can also be applied to inbound populations that are within the scope of UK NI and to outbound populations who meet particular criteria. There are two peculiarities about modified PAYE/NIC that may have an impact on the calculation of the apprenticeship levy, in addition to the issue noted above about identifying the population to whom the levy will apply.

The first is that in addition to an in-year true up that is undertaken in month 12 for modified PAYE, for modified NIC, there is also a true up exercise undertaken after the tax return filing deadline (31 January following the end of the tax year). This takes account of any differences in final tax return numbers compared with the initial estimate and any extra amounts due will be paid with a NIC settlement return, the due date for which is 31 March following the end of the tax year concerned. Adjustments to the apprenticeship levy figures may also be required because of this, as the amounts that are subject to employer's NIC are also likely to be affected. It is, however, not yet clear how any adjustment for these figures is to be made. If it is by means of an earlier year update, it is not clear how any payments due will be taken outside the interest and penalty regime that would normally apply to payments made after the strict due date.

The second difficulty is that for modified PAYE/NIC for inbound employees many employers have historically not distinguished between cash pay and benefits in kind, as the only consequence of them failing to do so was that they would potentially overpay employee's NI on benefits in kind provided. The amounts involved have not typically justified a detailed analysis to arrive at an accurate split between Class 1 and Class 1A charges, but the extra 0.5% cost may encourage employers to consider this more seriously in the future.

What does the apprenticeship levy mean for the construction industry?

The Construction Industry Training Board has proposed that employers within the construction industry should pay a CITB levy at 0.35% in addition to paying the Apprenticeship Levy at 0.5%, in respect of those working under PAYE in the construction industry. Unless this is changed, employers in the construction industry will be hit harder than other industries, as they will potentially face a total of 0.85% in combined training levy payments for their PAYE workers.

Accessing and spending the levy for employers in England

Assuming that the employer only has operations in England, payments made to HMRC under the levy are wholly credited to the employer's Digital Apprenticeship Services Account (DAS), maintained on an external, government controlled system. The government will also 'top up' payments made into the DAS by £1 for every £10 paid in by an employer. This '10% top up' will notionally be made at the same time as the payment by the employer, but in reality is likely to be made a few days later for administrative purposes. Once the 'top up' is made, that amount is indistinguishable from amounts paid by the employer (i.e. any future use of the DAS makes no distinction based on the source of the funds).

Using the funds is, however, likely to be more problematic than spending money might be assumed to be. The DAS can be used to fund apprenticeship training for the employer's employees, but the apprenticeship must be:

- provided by a government approved training provider;
- working towards achieving an approved apprenticeship standard or apprenticeship framework;
- of at least 12 months' duration; and
- involve the apprentice spending at least 20% of their time in 'off the job' training, together with learning job-specific skills and working with experienced staff.

In addition, the employer cannot recover cash payments from the DAS in any circumstances. Rather, payment will be made to the training provider directly by the government using the DAS funding. Further, amounts paid in to the DAS (including the 10% top up) expire after 24 months, with payments to training providers allocated on a FIFO basis (i.e. it is assumed that the oldest payment into the DAS is

used up first in making any payments to training providers).

That does not mean that employers cannot establish approved training providers within their own group which could potentially access funds, assuming they are able to bring the training they provide for the group within an approved apprenticeship framework.

Upon expiry of funds in the DAS, the employer receives no refund or other benefit of any kind and the levy simply becomes an expense. Many employers have expressed doubts about whether they will really be able to use the funding, generous though it may appear, because the ‘day release’ requirement may make it difficult to fit the new style apprenticeships to their business needs.

In particular, many employment agencies whose business is about the supply of labour to third parties will not be in a position to offer apprenticeships to the people on their books and will regard the levy as a sunk cost. If this is ultimately passed on to their customers, as increased rates for temporary labour, employers may feel they are paying twice over for funds that they are struggling to access. It could be argued that this approach is reasonable in order to prevent employers revisiting their existing employment structures and recruiting their entire workforce en masse via recruitment agencies so as to avoid the levy, but additional fees applied by the agencies would probably cancel out the 0.5% saving.

Potential future transfer of DAS funds

Although the government has a stated future aim of allowing transfers between employers in some circumstances (e.g. between members of a VAT group or across companies in a supply chain), the mechanism for any transfers, together with any restrictions have yet to be determined. For this reason, transfers are not expected to be possible before 2018 at the earliest.

Employers with operations in other parts of the UK

The apprenticeship levy is collected in exactly the same way throughout the UK, but for employers with operations in different parts of the UK the funding is divided. The split between the UK’s member states is calculated on the basis of the number of

employees that the employer has in England, Scotland, Wales and Northern Ireland at the start of the tax year. So, for England, the fund received by HMRC is allocated to the employer's DAS account as explained above, based on the proportion of their current workforce with home addresses in England (employers should be able to view the proportion of their funding allocated to the DAS account already through the digital apprenticeship service).

Funding is allocated to the authorities in each of the UK nations, as they are empowered to decide how to manage their own apprenticeship programmes, including how funding is spent on apprenticeship training.

HMRC's Manual helpfully states that any employer who is levy-paying, with operations based wholly or partly in Scotland, Wales or Northern Ireland, will need to engage with the relevant funding authorities for funding apprenticeships located there. Details of the Scottish government's plans for funds allocated to them may be accessed on the Scottish Government website, but at the time of writing, details of how the devolved governments in Wales and Northern Ireland intend to structure apprenticeship training have yet to be published.

Conclusion

Many employers have expressed concerns over whether the levy in its current format is fit for purpose, because it is so difficult to fit the real training opportunities they already offer within the straightjacket of apprenticeship as defined for the purpose of accessing the DAS funding. It is crucial that they also keep in mind the challenges involved in calculating the levy correctly, particularly in more complex situations involving groups of companies or international assignees. A careful review of the population that will be covered and appropriate exclusions will help payrolls to manage expatriates appropriately. Considering how to utilise the levy allowance in a group context at the start of each tax year is equally important, if employers are to avoid the arbitrary way in which the law reallocates it in the case of any claim that may be more or less than the £15,000 the law prescribes.