Integrating the operation of income tax and National Insurance contributions

Working Group 1
Meeting 3
8th February 2012

Attending

John Hampton  BT / CBI
Helen Hargreaves  CIPP
Sue Illingworth  Prudential / CIOT
Anne Redston  ICAEW
Clive Johnson  Association of International Accountants
Alistair Gibson  Aviva
Derek Kelly  FCSA
Kate Upcraft  ISIS

Peter McDonald  HMT (Chair)
David McDowell  HMRC
Mellannie Merrifield  HMRC
Samantha Tennakoon  HMRC

State of misalignment

The Group have been building a table of misalignments in the “earnings base” between tax and NICs. Any changes since the last circulation of the table were discussed.

Substantive discussion: the current situation with respect to the tax/NICs treatment of business expenses

Current misalignments in the tax and NICs treatment of expenses were presented by HMRC.

The Group noted that the misalignments which centred primarily on how the end result was achieved rather than what the end result produced were:

- differences in the tax and NICs definition of a business expense
- cash reimbursement/ advancements to cover mixed business expenses & /private costs
- vouchers
- Credit card and/or token use
- pecuniary liabilities
- round sum allowance
- the £8,500 rule (which does not exist within Class 1)

It was noted that many of the remaining misalignments between tax and NICs existed because of the difference in assessment period. If NICs moved to being assessed on an annual, cumulative and aggregated basis like tax,
these misalignments could be removed (e.g. NICs having only the one approved mileage rate and tax having two).

It was noted that with regard to business expenses that qualify for tax relief, the eventual outcome for both tax and NICs is virtually identical (neither tax nor NICs are due on such expenses). However, the way in which that outcome is achieved is fundamentally different in relation to the both the statutory tests and administrative handling.

The Group discussed any burdens they currently experienced with regard to expenses as a result of the differences between tax and NICs. Points raised in discussion included:

- Reimbursements for expenses that are mixed use were cited as one of the biggest burdens.
- It was suggested that the majority of employers would not know the specific differences between the tax and NICs treatment of expenses. It was suggested that many think that, like for tax, the NICs position will get sorted out at the end of the tax year.
- Approved Mileage Allowance Payments (AMAPS) were specifically mentioned as an area of difficulty. It was suggested that most don’t understand why there is a second rate for tax.
- Those who had a dispensation in place did not find administering expenses a huge burden.

Substantive discussion: options for alignment

Two options for alignment were considered: a) following the current tax model and b) following the current NIC model. HMT and HMRC emphasised that no decisions have been taken on whether to align in the area of expenses and how this could be done.

The first option discussed involved aligning NICs with the current tax model. Points made in discussion included:

- This would require NICs being assessed on an annual, cumulative and aggregated basis (and therefore has strong dependencies on the options being looked at by Working Group 2)
- This would mean employers reporting the expenses on the P11D for both tax and NICs purposes.
- Tax and NICs on the full amount would be collected from the individual through a coding adjustment to the employee’s code (requiring a NICs code).
- The employee would be entitled to claim both tax and NICs relief on any qualifying business expenses.
- This option would pose a difficulty in administering the employer secondary NICs liability (either the employer would have to claim relief on the secondary NICs they have paid at the end of the year or maintain a separate system for administering expenses for the secondary charge).
This option was not attractive to the Group because of the difficulty in administering the secondary NICs charge, fears of increasing complexity to the P11D and fears that this option would increase the burden on employees.

The second option discussed involving aligning tax with the current NICs model. Points made in discussion included:

- This option would effectively mean that employers would ‘self-dispense’ for all business expenses for the purposes of tax and NICs.
- The payroll would identify any ‘profit’ element of expense payments and subject this element to tax and NICs through the payroll.
- No further action would be required by the employee, employer or HMRC.

The Group was not attracted to this option due to the requirement on employers to make a judgement as to the private use of any expense payment for each employee, each pay-period. The delay in employees submitting their expenses claims contributed to the difficulty in being able to administer this within the pay-period.

The fact that the NICs system currently requires the employer to make this judgement each pay period was discussed. There were differing views among the Group on the current employer practices with regards to the NICs treatment of expense payments in the pay-period:

One scenario presented was that if there was any doubt as to the private use for which an expense payment was reimbursing, then Class 1 NICs would be charged on the whole amount. This was seen as the route of least risk.

Another scenario was that employers may not subject any part of the expense payment to Class 1 NICs through the pay-roll. This is because some employers may hold the belief that the NICs treatment is similar to tax and the position for the employee will be rectified at the end of the year.

**Next steps**

At the next meeting the Group will consider the work of Working Group 2 (who are looking at the calculation of NICs) and the interdependencies with option to further align the base between tax and NICs.