Dispensing with dispensations

Employment Tax

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Mark Groom and *Samantha Mannall* explain the upcoming changes to employee expenses legislation and the abolition of P11D dispensation notices

Key Points

What is the issue?

P11D dispensations are ending and associated expenses and benefits legislation is changing from April 2016

What does it mean to me?

Employers need to review their current expenses policy and dispensation agreements with HMRC; scale rate payments and fixed-sum allowances require new HMRC agreements; and reimbursement of travel and some other expenses in conjunction with salary sacrifice will cease to be effective

What can I take away?

Practical insights and recommendations for employers preparing in advance of the changes

From 6 April 2016, business expenses that are deductible by employees will become exempt if reimbursed by employers, subject to conditions. They will not be reportable by anyone and dispensations (reporting waivers) will be abolished. In the case of tax-deductible allowances, these and any other bespoke matters now included in dispensations, will need to be covered by new and separate agreements with HMRC (called approval notices). At the same time, any reimbursement of travel and some other expenses and certain benefits in conjunction with salary sacrifice schemes will become taxable.

At the time of writing, we are awaiting HMRC guidance on the changes but we recommend that action is taken by employers sooner rather than later.

How is the legislation changing?

FA 2015 brings in ITEPA 2003 ss 289A–E, effective from 6 April 2016, which does the following:

- removes HMRC's powers to grant dispensations (by omitting ITEPA 2003 ss 65 and 96);
- exempts expenses and benefits that would otherwise be deductible from earnings under ITEPA 2003 Chs 2, 5 of Pt 5, or Ch 3 of Pt 5, such as travel and subsistence expenses, business entertainment and professional fees and subscriptions;
- makes it a statutory requirement for employers to operate a system for validating employee expense claims, including those reimbursed by way of allowances;

- provides that regulations may exempt particular types of expense payment;
- introduces sampling rules to support employer requests for the agreement of bespoke allowances; and
- disapplies the new exemption when expenses are reimbursed in conjunction with salary sacrifice arrangements.

The National Insurance Regulations, outstanding at the time of writing, are expected to mirror the tax changes.

Scale rate payments

If current dispensations cover an expense allowance, *per diem* or scale rate payment, employers will have four options:

1. **HMRC benchmark rates**. In the case of subsistence, new regulations provide for allowances of £5, £10 or £25 depending on the duration of the travel. However, it should be noted that the latest consultation on travel and subsistence published in September 2015 proposes that there should be no relief for ‘day subsistence’, although we would be surprised if that were adopted before April 2017. For employees travelling outside the UK, we understand HMRC will still accept subsistence rates up to the Foreign and Commonwealth Office (FCO) guidance *Worldwide Subsistence Rates* (although there may be some rationalisation of the current complex country-by-country approach).
2. **Bespoke rates**. Employers will need to conduct a sampling exercise to provide evidence to HMRC that the bespoke rates requested are a ‘reasonable estimate of the amount of expenses actually incurred’. If satisfied, HMRC will issue an ‘approval notice’ that will last for up to five years when it will need to be renewed.
3. **Industry/sector rates**. We understand that employers will still have to apply for an approval notice to use standard industry or sector-specific rates published by HMRC, but no sampling exercise would be required.
4. **Reimburse subject to tax and NIC**. This will be the only option for employers that now reimburse travel and subsistence expenses under arrangements by which earnings vary with the expenses payments. Note that this wording goes beyond the normal meaning of ‘salary sacrifice’ arrangements. Employers can still make such reimbursements subject to tax and NIC and employees can claim tax relief for the time being, subject to further restrictions that apply to

individuals engaged through intermediaries and any further restrictions to day subsistence in the future.

System for checking expenses

Employers will need a system in place to check that employees have incurred expenditure before they make a tax-exempt reimbursement by way of a scale rate payment. We understand the new framework will be built around current guidance at *Employer Income Manual* (EIM) 30059.

We understand HMRC accept expenditure may be evidenced in various ways and will take a pragmatic approach by not insisting that receipts have to be retained in absolutely all cases (eg contactless payment used on public transport) to qualify for exemption. Such an approach is welcome, although we will need to wait for further guidance on what exactly will be required.

Five-year agreements and transitional arrangements

Bespoke rates of allowance agreed in a dispensation within five years before 5 April 2016 will be allowed to continue under a new agreement until the fifth anniversary from their original agreement. However, a new approval notice will be needed from 6 April 2016, although sampling will not be required if nothing material has changed. All bespoke allowances must be renewed on their fifth anniversary whenever they are or were agreed.

Salary sacrifice arrangements

As noted, the new exemptions exclude any payment or reimbursement of expenses or provision of benefits within ITEPA 2003 Chs 2, 5 of Pt 5, or Ch 3 of Pt 5 provided through salary sacrifice. This does not prevent employees claiming a deduction under self-assessment, nor does it affect other expenses or benefits covered by other parts of the Act.

Partially exempt expenses and benefits

For expenses in which only part of the amount paid or reimbursed by the employer qualifies for a deduction, the new exemptions will apply to the qualifying amount. For example, an employer may reimburse an employee’s home telephone bill. Only the business calls would qualify for a deduction and will be covered by the new exemption. The rest of the reimbursement will have to be reported on form P11D.

In contrast, benefits are not considered separable into taxable and exempt amounts in the same way as expenses. Therefore, unless the whole of the benefit qualifies for a deduction, the new exemptions cannot apply. Unless the employee makes good the full benefit – which is unlikely when partly provided for business purposes – the whole benefit will have to be reported on form P11D. The employee will then need to claim a deduction for any business use element through self-assessment (or using a form P87). An employer may provide accommodation for an internationally mobile employee travelling with a family member or spouse. The full benefit will still need to be reported on form P11D, and the employee will have to claim relief for a portion of the benefit.

We understand that HMRC are reviewing the consequences of partially exempt expenses and benefits for employers that have modified PAYE schemes or are going to use the new PAYE special arrangement for short-term business visitors who have no more than 30 UK workdays. There could be significant cash flow disadvantages.

How employers can prepare to stay compliant

There are several key steps that employers should take now in advance of the changes:

- Review current dispensations to determine whether all the items will be covered by the new exemptions, in particular bespoke allowances or other unusual items such as the business element of chauffeurs or jets used by senior executives.
- Determine where new agreements with HMRC will be needed, and the steps required to obtain new approval notices where required. Consider sampling, internal processes and new expenses checking procedures.
- Consider how salary sacrifice arrangements will be affected and how you will exit from them with minimum disruption.
- Ensure your approach to partly exempt expenses or benefits is compliant, noting the difference between the two.
- Review and update expense policies, documents and provide additional training for employees or managers involved in reviewing claims.

- Review international aspects of your current policies, in particular positions taken on payroll, P11Ds and tax returns.
- Identify cases in which it is uncertain that an employee’s expenses meet the conditions of the exemption. Take advice and/or discuss with HMRC how best to treat these. There is some uncertainty as to whether inclusion on P11Ds will be permitted; in any event, this would come with a Class 1A NIC cost.

Conclusions

HMRC’s new guidance, expected later this autumn, should provide some further clarity on sampling methodologies, industry-specific scale rates and frameworks for checking expense claims. Meanwhile, employers should review agreements they have with HMRC and identify which will be affected by these changes, what new agreements will be required and which processes will need to change for their business to remain compliant.