

Important newsflash

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Statement by HM Revenue & Customs

Pay day by pay day tax relief models

Who should read this statement

- * All umbrella companies, employment businesses, labour providers and employers engaging and paying temporary workers.
- * Temporary workers engaged under employment contracts.
- * Those in receipt of the services of temporary workers supplied by employment businesses and labour providers, particularly, but not exclusively, workers paid at or near the National Minimum Wage.

Background

HM Revenue & Customs (HMRC) understands that a number of umbrella companies, employment businesses and labour providers are proposing to operate a business model which applies tax, and in some case National Insurance contributions, 'relief' on a pay day by pay day basis: a 'pay day by pay day relief' model.

Under pay day by pay day relief models, temporary workers engaged under overarching employment contracts and who incur travelling and subsistence expenses which are eligible for a tax deduction under section 338 Income Tax (Earnings and Pensions) Act 2003 (ITEPA), are paid a gross pay which is intended to be compliant with the National Minimum Wage legislation. However, rather than then subjecting this gross pay to Income Tax and National Insurance, the employer applies tax and National Insurance contributions 'relief' to the amount of expenses which the employee has incurred with the effect that only the balance is subjected to Income Tax and National Insurance. This tax and National Insurance contributions 'relief' is applied each pay day.

Tax and Social Security legislation

The information obtained by HMRC thus far indicates that the model described above does **not** comply with the Taxes Acts or Social Security Acts and associated Regulations.

How tax relief is applied

An employer operating such a model is not accounting for the correct Income Tax (PAYE) due to HMRC.

Income Tax is an annual tax and is assessed in respect of a particular 'year of assessment'. Any deductions from Income Tax (for example as provided for under section 338 ITEPA) are made from the total income for the year of assessment.

There are various requirements which must be met in order to receive the benefit of the tax deduction **at the end of the tax year**. These include that the claim for the deduction by the employee must be made to HMRC - there is no statutory framework for employers to operate the reclaim process.

National Insurance disregards

An employer operating such a model would also not be accounting for the correct employers' and employees' National Insurance contributions due to HMRC.

For the purposes of calculating an employee's earnings, the Social Security Contributions and Benefits Act 1992 provides that 'earnings' includes any remuneration or profit derived from the employment, including wages and salaries.

The Social Security (Contributions) Regulations 2001 provide that payments made by the employer to the employee to cover certain travelling expenses incurred by an employee can be disregarded in the calculation of earnings for National Insurance purposes from the employed earner's employment for the purposes of earnings related contributions (ie where such payments are made, those payments will not count as 'earnings' for the relevant earnings period). However, the relevant legislation does not provide for a **deduction** from the amount of that employee's earnings where the employee meets the travelling expenses out of total income/earnings.

Summary of position

HMRC have set out below the ways in which tax relief and/or a National Insurance contributions disregard can be given effect.

Separate and distinct expense payments or reimbursements made by an employer which are covered by a dispensation

- * The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- * The employer **separately and distinctly** pays or reimburses an additional amount in respect of certain travelling expenses.
- * If those additional payments in respect of travelling expenses are paid under the terms of a valid dispensation, they may be paid without any additional liability to tax.
- * The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Separate and distinct expense payments or reimbursements made by an employer that are not covered by a dispensation

- * The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions.
- * The employer **separately and distinctly** pays or reimburses an additional amount in respect of certain travelling expenses.
- * If those additional payments in respect of expenses are not paid under the terms of a valid dispensation, those additional payments would count as general earnings but the employee can claim a tax deduction from earnings from HMRC at the end of the tax year in respect of expenditure which is eligible for a deduction through Self Assessment.
- * The additional payments in respect of expenses would be disregarded for National Insurance purposes.

Expenses paid by employee out of total income received

- * The employer pays an amount at least equal to or greater than the National Minimum Wage to ensure compliance with the National Minimum Wage legislation. The income and earnings are subject to Income Tax and National Insurance contributions but there is no separate and distinct payment in respect of expenses. The employee pays for his travelling expenses from his total income.
- * The employee can claim a tax deduction from HMRC at the end of the year in respect of expenditure which is eligible for a deduction through Self Assessment.
- * No National Insurance contributions disregard is available in such circumstances.

What you should do

Those operating pay day by pay day relief models

Consider whether your business model is compliant with tax and National Insurance legislation. If you are in any doubt, you are recommended to seek advice from a professional adviser or HMRC. HMRC is seeking to identify those businesses currently operating pay day by pay day relief models.

Workers/businesses concerned about such models

You can provide HMRC with details, in confidence, about businesses operating such pay day by pay day relief models by email at Temporary workers here - http://www.hmrc.gov.uk/asplib/mailler/mailler_form.asp?dpt=TEMP_WORKERS