Tax Insider
HOW TO BEAT THE TAXMAN AND BOOST YOUR INCOME!

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Tax Efficient Ways to Reward Employees

By Sarah Bradford

The tax system has a fair number of employment-related exemptions built in. Many have underlying political aims and seek to encourage what is perceived to be desirable or responsible behaviour. Exemptions for green travel fall into this category. Nonetheless, regardless of the reason for their introduction, the exemption can be utilised to reward employees in a tax-efficient manner.

It is important to note however, that a benefit is only a benefit if the employee actually wants it. Many employers allow the employee to tailor his or her remuneration package by giving up salary in return for a benefit. That way the employee receives benefits that he or she actually wants and, where the benefit is exempt from tax and National Insurance, saves the tax and National Insurance that would have been paid had the employee taken the salary and funded the benefit from his or her post tax and National Insurance salary.

However, salary sacrifice schemes are not without complication. To be effective, the employee must give up the higher salary for good in exchange for the benefit. If the employee has the right to revert back to the higher salary at will, HMRC will tax the employee as if the higher salary had been received. Where using salary sacrifice schemes to take advantage of exempt benefits, it is important therefore that the documentation is watertight and makes it clear that the switch from a higher salary to a lower salary plus benefits is a permanent one.

There are a wide range of exempt benefits that can be used to form part of a tax efficient remuneration package. Some of the more popular ones are considered below.

Childcare

The high cost of childcare means that working parents are likely to value highly any help towards the costs. The provision of childcare vouchers is an effective way to take advantage of the exemptions on offer. Employees can be provided with childcare vouchers of up to £55 per week of care without triggering a tax liability.

If an employee gives up a salary of £2, 915 a year (£55 x 53 weeks) in exchange for

childcare vouchers, the employee will save tax and National Insurance. The amount saved will depend on the employee's personal circumstances. For example, if the employee pays tax at 22% and National Insurance at 11%, the employee will save tax of £641.30 and National Insurance of £320.65. Gross salary of £2915 would equate to a net salary of £1953.05. This means that an employee who takes the salary can `purchase' childcare of £1935 from £2915 of salary whereas the employee who gives up the salary in exchange for vouchers receives the full £2915 of childcare. This is certainly a worthwhile swap.

The same principle can be applied to the provision of other exempt benefits, including exempt childcare provided by means of a workplace or commercial nursery or childminder. In all cases, the terms of the exemption must be met.

Pension Provision

An employer-provided pension can be a significant benefit. Employers can make contributions to occupational or personal pension plans without triggering a tax charge. This can significantly enhance an employee's remuneration package and is a tax efficient way of rewarding employees.

Mileage Allowances

The system of statutory mileage allowances enables an employer to make tax-free mileage payments to employers. This can amount to quite a significant tax-free sum. The allowance can be paid in respect of cars (40p per mile for the first 10,000 business miles and 25p per mile thereafter), motor cycles (24p per mile) and cycles (20p per mile). If these sums are not exceeded there are no reporting requirements. If higher amounts are paid, the excess is taxable and if lower amounts are paid, the employee can claim tax relief on the shortfall.

The employer can also pay tax-free passenger payments of 5p per passenger, per mile, provided that the passenger is also an employee for whom the journey is a business journey. Again, any excess is taxable. However, the employee cannot claim relief if the employer does not make a passenger payment or pays an amount less than 5p per mile.

Other Transport, Travel and Subsistence Exemptions

Continuing the transport theme, there are a variety of other tax-free options available. The first of these is workplace parking. The employer can provide an employee with a parking space for a car, motorcycle or other cycle without giving rise to a tax charge. In city centre locations particularly, this can be a valuable benefit, predominantly for private purposes.

If an employee travels in the course of his or her work, the employer can pay a tax-free allowance of up to £5 per night in the UK, and £10 per night abroad to cover incidental expenses. If the employee travels a lot, this can add up.

Some exemptions require a greater capital outlay on the part of the employer. Within this category is the provision of a works transport service, whereby the employer provides a bus or minibus service to transport employees to and from work and the employee effectively enjoys tax-free home to work travel. This can generate significant savings for the employee. Employers without the resources to operate such a service can achieve a similar result by subsidising a public bus service.

Employers who are keen to encourage their employees to keep fit can provide cycles and cycling safety equipment tax-free.

Other more limited transport-related exemptions include travel and subsistence during public transport strikes and travel home as a result of late working or the failure of car sharing arrangements, as well as home to work travel and the provision of cars for the disabled

Education and Training

Education and training can be a significant benefit, reaping long-lasting rewards for the employee. Provided that certain conditions are met, the employer can provide work-related training and individual learning account training tax-free.

Recreational Benefits

Perhaps more popular are the exemptions for recreational benefits. These include the ability of the employer to provide sporting or other recreation facilities tax-free provided that certain conditions are met. This would cover, for example, a workplace gym, provided that the facilities were not made available to members of the public generally.

Also within this category is the well-known exemption for annual parties and functions. The employer can provide functions to a total cost of £150 per head without creating a tax liability.

Entertainment provided by a third party is tax-free, as long as the employer has not procured its provision and it is not being provided in recognition or anticipation of services.

Removal Benefits

In the event that an employee moves house because of changes in his or her job, the exemption for removal benefits and expenses enables the employer to provide tax-free assistance to the tune of £8,000. As with all exemptions, certain conditions must be met.

Miscellaneous Benefits

In addition to the benefits outlined above, there are a number of benefits which can be provided to employees tax free and which can be used as part of a tax efficient remuneration strategy.

These include the provision of free or subsidised meals, use of a works bus service, meals provided to cyclists on cycle to work days, eye examinations, overseas medical treatment and a tax-free allowance to home-workers of £2 per week.

Conclusion

The provision of exemptions within the tax system allows employers to exploit these exemptions to reward employees in a tax efficient manner. The employee's remuneration package can be tailored to include benefits of value to the employee.

In planning any remuneration strategy, the value of exempt benefits should not be overlooked.

"Show me the way to go home"… Late Night Taxis for Employees and the Office Party Trap

By James Bailey

It will soon be the season of staff parties and it is well-known that there is an exemption from tax for these (up to a limit of £150 per head, after which the whole cost becomes a taxable benefit).

There is also a different exemption for the occasional taxi home provided by an employer, but it is important to remember how both of these work and that there can be problems if you try to combine them.

Taxis Home

If an employee is required to work late, he may have problems getting home if he relies on public transport (some would say you don't have to work late to have problems with public transport, but there is no tax exemption for that) and if the detailed rules are met, paying for a taxi home for him will not be a taxable benefit.

There is also an exemption where employees have a car-sharing arrangement and this arrangement fails for some reason, such as a mechanical breakdown or illness.

Late Working

In order to qualify for this exemption, the employee must have been required to work later than usual, and also later than 9pm. If by the time he goes home public transport has ceased, or if "it would not be reasonable to expect the employee to use it" (which would certainly cover the situation around where I live after 9pm), then the employer can pay for a taxi without there being a taxable benefit.

It is also a condition that such situations only "occur irregularly" and there is an overriding limit of under 60 such journeys a year for any employee - I must say, if I had to work until after 9pm on 59 occasions a year, I would think it was happening with depressing "regularity", but the point of the rule is that the exemption is not available if, for example, an employee in a night club works late every Friday night even though the total number of journeys will be less than 60 in the year.

Car Sharing

If employees regularly share a car to get to work and this arrangement fails "because of unforeseen and exceptional circumstances", then again a taxi can be provided with no tax charge. Note that in this situation the exemption applies whether or not it is after 9pm, and whether or not the employees have had to work late.

The same limit of fewer than 60 journeys applies here - though if I shared a car to work with someone and it broke down 59 times, I think I would be starting to "foresee" that it might do so again!

Staff Parties

The "late night taxi" exemption only applies to situations where the employee has been required to work late, so it would not apply to a journey home by taxi from a staff party.

There is a separate exemption for the cost of staff parties, which exempts them from tax provided the annual cost per head is less than £150 - so if spouses or boy/girlfriends are invited the cost limit is £300 per couple.

There is a trap for the unwary here. The exemption for the staff party refers to the cost of the party itself and "any transport provided for persons attending it". If your staff party is close to the £150 per head limit (or if you give several such parties and the combined total is getting near £150), then paying for a taxi (or, for example, a minibus) home for some or all of the staff could take you over the limit and make the whole cost of the party concerned a taxable benefit, because the exemption for taxis home does not apply to a journey home from a staff party.

In the case of car sharing arrangements, I suppose it could be claimed that paying for a taxi home because the car sharers had overindulged at the staff party and were unfit to drive was an "unforeseen and exceptional circumstance", but even in the season of goodwill, I wouldn't like to argue that one with the inspector!

Give What You Can Afford - IHT and "Normal Expenditure Out of Income"

By James Bailey

Inheritance Tax is charged at 40% on the value of your estate (above £300,000) when you die, and that value includes any gifts you have made in the previous seven years.

There are various exemptions for lifetime gifts, such as for small gifts (under £250 per person per year), and an annual exemption of £3,000, but any other gifts remain part of your estate for IHT purposes for seven years after they were given away.

There is another important exemption, however, which more people should be aware of. Section 21 of the Inheritance Tax Act 1984 says that a gift to another person is not to be included in the seven year total if it passes all three of these tests:

- It was part of your "normal expenditure"
- It was made out of your income
- Making it did not affect your normal standard of living

Each of these three tests must be passed, and none of them is as simple as it appears at first:

"Normal Expenditure"

In order to be considered "normal", the gift must be shown to be part of a pattern. If you have given £5,000 to each of your children every year for the last three or four years then this test is clearly passed, but it is possible to establish a pattern in less time than this. This is one case where a deed of covenant can be useful as it is a binding legal promise to pay a certain sum at specified intervals.

The gifts do not have to be given every year, but they do have to form part of a regular pattern. When starting a sequence of such gifts, it is normal practice (if a deed of covenant is not used) to write a letter saying something to the effect that you intend to make similar gifts in future years, though this is not essential - and it will not help if in fact you do not make the future gifts.

The gifts do not have to be to the same person, but they do have to be to the same class of people. For example, you might have three children and give £10,000 to one of them in one year, £10,000 to another the next year, and so on. That would qualify, but if instead you gave £10,000 to charity every year, you could not in one year give £10,000 to a child instead and claim that was part of the annual pattern of a gift of £10,000 - a child is not the same as a charity.

The sums given must be roughly the same every year - this does not have to be precisely accurate, but each gift must fit the pattern and not be an exception to it.

"Out of income"

This means made out of the income for the year in question, not out of savings from previous years' income, but the legislation does say the test is to be done "taking one year with another", so if you have established a pattern of "normal" giving that came from your income, the fact that in one year it came out of last year's income (because, for example, your business had a bad year, or because you were between jobs) will not spoil the pattern.

Because the gifts must be "out of income", a gift of a capital item, such as a painting or some shares, would not qualify unless you can show that you bought it with income in that year for the purpose of giving it as a gift. In other words, if you use income to buy a gift that syou then give away, that will qualify, but if you give (say) a painting you have owned for some time to your nephew, that would not count because it was not given "out of income". Be careful here - unless you regularly give things rather than cash, you may still fail the "normal" test - it is safer to stick to cash.

"Usual standard of living"

The final test is the hardest and the one that calls for some good record keeping. You must be able to show that after making the gift, you had enough <u>income</u> to maintain your usual standard of living. Notice that you must have enough income; having to live on capital after making the gift will lose you the exemption.

Once again, there is a "taking one year with another" tolerance, so just because you have a bad year, you will not lose the exemption if things subsequently improve and you are able to continue to make the gifts out of income in future.

Looking Back

Although this exemption is usually deliberately achieved as a result of tax planning advice, anyone dealing with the estate of a deceased person who had a good income should check to see if some or all of the gifts given in the final seven years of their life might benefit from this exemption. Whether it is due or not is a question of fact, and if the gifts pass the three tests described above, the exemption is due, even if the deceased did not deliberately set out to achieve it.

Health Warning

If you want to try to qualify for this exemption, make sure you take advice before starting. This article has only scratched the surface of the subject and there are many pitfalls. To take just one example, capital repayments from certain bonds and payments to nursing homes out of "lifetime care plans" are <u>not</u> income for the purposes of this exemption.

Living on the Job - Accommodation Provided for Employees

By James Bailey

Some jobs come with somewhere to live, either as a "perk" or because, for whatever reason, the employer wants the employee to live in a certain property.

As a general principle, accommodation provided by an employer is a taxable benefit, but there are exceptions to this:

"Necessary for the proper performance of the duties"

This is a very tough test - it involves showing that in order to do the job, it was essential to live in that property and in no other, so it is not enough that you need to be near your work in the case of an emergency, for example. Examples of employees who are considered to pass the test include:

- Agricultural workers living on farms or estates
- Lock-keepers and level crossing keepers (are there still any of these around?)
- Full time caretakers living on the premises
- Golf club stewards and green keepers
- Pub managers living in the pub
- Sheltered housing wardens, provided they are on call outside normal working hours

That is not an exhaustive list, but in my experience it is very difficult to persuade HMRC that the exemption applies to any other types of employee.

Where this exemption applies, the employee is also exempt from tax if the employer pays the council tax and water bills, but there is still a tax charge on heat and light, and on the use of any furniture, though this cannot be greater than 10% of the employee's pay.

"Provided for the better performance of the duties" and "customary"

The first part of this test is not so onerous, but the problem comes when you try to persuade HMRC that it is "customary" to provide such employees with accommodation.

HMRC accept the test is met for such employees as policemen, soldiers, clergymen, prison staff, and also for managers of newsagents if they have a paper round. Boarding school head teachers and other staff with pastoral responsibilities such as housemasters and

matrons (and bursars, for some reason) also get by, as do stable lads in racehorse yards.

Assistant vets and managers of camping or caravan sites pass the "customary" test, but the "better performance" test has to be looked at for the particular case.

This list is not exhaustive, but again, HMRC resist adding to it as much as they can - indeed, some of their officers have told my clients that their employees cannot be exempt "because they are not on the list", which is nonsense.

The same rules about other expenses apply as they do for "necessary" employees.

Representative Occupiers

This is a very rare exemption - rare enough for most HMRC officers not to have heard of it - and it applies only to an employee in a post who qualified as a "representative occupier" as at April 1977. It also applies to the successors to that job if their 1977 predecessor qualified for the exemption. Broadly speaking, it applies where in 1977 the employee concerned was required to live rent free in a particular property by his employer, and this requirement was for the better performance of the duties of the job.

As with the two statutory exemptions above, similar rules apply as regards to other accommodation expenses.

Security Exemption

This only applies where there is a specific threat to an employee's personal safety and is so rare we can ignore it here.

Tax Charge if No Exemption

The taxable benefit on accommodation is extremely complicated where none of the above exemptions apply, but very broadly the charge depends on whether the accommodation concerned is rented or owned by the employer. If it is rented, the benefit in kind is the rent paid but if it is owned by the employer, the benefit is based on the cost of the property, or in some cases with older property, its market value.

Essentially, you deduct £75,000 from the cost or market value and then apply the "official rate of interest" (currently 6.25%) to the balance. To this you add the "annual value" of the property, which is (in England and Wales) the 1973 gross rating value (or if the property was not there, an estimate of what this would have been).

If only to avoid the nightmare of doing this calculation (which I have simplified considerably for the purpose of this article), it is worth considering if your employee qualifies for any of the exemptions described above!

TAX TIPS

1. To Spend Now or Later?

If you run a business (in a company or as a sole trader) and you are thinking of significant investment in plant and machinery, you need to consider whether to spend the money now (50% first year allowances, but only 20% writing down allowance on the balance for 2008/09), or wait until 2008/09 (100% first year allowances on the first £50,000 spent).

James Bailey

2. Are all Professional Fees Allowable Expenses?

If you are selling your business, some of the professional fees you pay will be allowable expense and some will not. Check carefully with your advisers to make sure that they allocate the fees they charge you correctly.

James Bailey

3. IHT 'Gifts'!

Gifts totaling up to £3000 in a tax year are ignored for IHT - and if you did not use the £3000 in the previous tax year it can be added to make £6000 that will never be taxable, even if you die within seven years of making the gift

James Bailey

4. Other Income

If you are an employee, and you also have some other income (such as bank interest or rent) HMRC can "code it out" by altering your PAYE code so that the tax is collected throughout the tax year through your pay packet. If you don't want them to do this, you can request this is NOT done, by ticking Box 23.1A. of your self-assessment return.

James Bailey

5. Can You Claim the VAT on Accountancy Bills Relating to Personal Tax Advice?

This is a question often asked by sole traders, partners, and even directors of OMBs, with the answer being "yes" if you can get your tax adviser or accountant to bill you in a manner that will be acceptable to HMRC.

HMRC accept that accountancy fees for a sole trader, partnership, or OMB normally relate to a number of services (e.g. general accountancy advice, VAT advice and income tax advice).

Although the income tax advice is, in reality, the responsibility of the sole trader/partner and not strictly a business expense, to avoid lengthy disputes, HMRC policy allows such fees to be recovered in full.

The only exception to this is where the accountant's fees clearly state that they relate to personal taxation matters, or where they are billed separately. So, in order to ensure full VAT recovery on these costs, firstly make sure that your accountant does not bill you separately for them, and secondly, make sure that the wording on the fee note is vague and general in nature. For example: "Preparation of accounts and general professional advice for the period..." should work just fine.

Andrew Needham

Registration Delays Hit All Time High

By Andrew Needham

Delays in VAT registrations continue to get worse, and can now take as long as three or four months for a seemingly straight-forward case. This compares with two months in 2006, and around two weeks a few years ago. Delays of up to six months are common when anti-fraud checks are carried out as part of the clampdown on carousel fraud. According to recent reports, it is now taking 30 days or more for registrations sent by post to even be opened by HMRC, and correspondence sent to them in support of applications is often lost, further complicating and delaying the process.

Businesses waiting for a VAT registration number can face severe restrictions on their capacity to trade. For example, small businesses without a VAT number may not be able to get invoices paid, or property deals can be unduly hampered because the law requires for some types of property deal that the buyer is VAT registered, and sellers are understandably unhappy about proceeding before HMRC have processed the paperwork. The time and cost of getting a business registered is also being adversely affected. Business advisers are now incurring significant time costs simply because of the delays, some or all of which are having to be passed on to their client businesses.

HMRC's handling of the issue has been less than sympathetic, as demonstrated by the recent posting on their website asking registration applicants not to bother phoning to check the progress of applications, as this may add to delays. Such is the size of the 'black hole' at Registration Units that applicants and advisers are forced to constantly check things with HMRC, such as whether the forms and supporting documents have been received, whether the case has been allocated to a caseworker, does the caseworker understands the applicant's particular circumstances, as well as trying to pre-empt the issue of pointless 'Request for Information' letters.

Clearly, the clampdown on carousel fraud is a major cause of the problem, but as carousel fraud is not about to go away, HMRC quickly need to address the long term management and staffing issues if the situation is ever going to improve. To make matters worse, HMRC recently admitted that the situation will continue to worsen due to an additional 20,000 VAT applications received from newly-incorporated businesses as a result of the managed service company legislation in the Finance Bill 2007. This makes the recent decision to close the Newry and Camarthen Registration Units all the more baffling.

There is little point in complaining about the matter. The Complaints Unit is so inundated that it takes a month just to acknowledge a formal complaint, and even then, is unable to give any indication of when the complaint will be dealt with. Apparently, HMRC's official policy is now that VAT registration delays are no longer a complainable matter, since all taxpayers are being equally disadvantaged, and no-one can say they are being unfairly treated!

The Tax Insider Gurus Answer Your Questions

Q1 I inherited a property in January, which is now being sold with an increase in value of £30k. Can I add my husband's name to the property and "double up" on the annual capital gains tax allowance?

A1 Provided the sale has not already been agreed, you can make a gift of a half share in the property to your husband (get a solicitor to deal with the details of this), and then when you and your husband sell it, you will both be entitled to set your annual exempt amounts (currently £9,200 each) against the capital gain on the sale.

Q2 I bought a second home in 2000, spent a year renovating it and then let it out for 18 months. I then lived in the house for 2 years as my only home after which I sold it and moved on. Am I entitled to Letting Relief on the gain for the period when the house was let?

A2 Provides HMRC agree that the property was your "only or main residence" for the period you lived there, then you are entitled to letting relief for the period the property was let. The relief is the LOWER of the following:

- £40,000
- The amount of the gain that is taxable because of the letting
- The amount of the gain that is exempt as your main residence (remember this includes the last three years of ownership of the property, whether or not you were living there throughout that period).

Q3 I'm purchasing a property for £240k which I intend to resell in 6 months time. I am paying the seller £220k now and the remaining £20k when I resell the property.

The question I have is - does IR see the £20k as a cost in the transaction and deductible for CGT purposes? For example if I resell the property for £300k, is my CGT liability £300k - £240k (as the £20k is seen as a cost in the trasnaction) or is it £300k - £220k.

A3 The £20K is a cost of the transaction, and the profit in your scenario would be £300K - £240K. However since you are purchasing the property with the intent to sell on in 6 months, the profit would not be a CGT liability but subject to income tax, and probably Class 4 NI.

Send your questions to: questions@taxinsider.co.uk for consideration in future editions.

Tax advice and help to solve your challenges at an affordable price!

The contributors to this e-zine are current practising specialists. They have made available an advice and helpline service to help resolve any UK and international tax matters.

Please visit www.taxinsider.co.uk for more information about this affordable service.

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Tax Insider

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