

Employee & volunteer taxation

made simple

Introduction 3

1 Employed or self-employed 4

2 Unusual or irregular
employment 6

3 Special situations for national
insurance contributions 7

4 Forms P11D for benefits
and expenses 8

5 Special arrangements 9

6 Exempt benefits 10

7 Termination payments 12

8 Volunteers 13

9 Conclusions 14

Further information 15



sayer vincent
consultants and auditors

Acknowledgements



This guide was produced with help from the partners and staff at Sayer Vincent, as well as support from staff and trustees of CFDG.

CFDG (Charity Finance Directors' Group) is the professional body for finance directors within the sector, and has nearly 1,500 members. CFDG provides assistance to charities on a range of issues, such as accounting, taxation, audit and other finance-related functions. CFDG's mission is to deliver services that are valued by members and enable those with financial responsibility in the charity sector to develop and adopt best practice.

For more information go to www.cfdg.org.uk



Sayer Vincent only works with charities and not-for-profit organisations. With five partners and over 35 professional staff we are one of the largest teams of charity specialists. Our work focuses on making charities more effective through improved infrastructure, reporting and governance. We help charities with mergers, systems implementations and training. Charities appoint us as consultants, internal auditors or external auditors. Working with a diverse portfolio of charities, we deliver rapid insights into your issues and problems and help you to find effective solutions to them.

For more information, go to www.sayervincent.co.uk

Published by CFDG
First published 2008
Copyright © CFDG and Sayer Vincent
All rights reserved

No part of this book may be reproduced by any means, or transmitted, or translated into a machine language without prior permission in writing from the publisher. Full acknowledgement of the author and source must be given.

CFDG and Sayer Vincent shall not be liable for loss or damage arising out of or in connection with the use of this publication. This is a comprehensive limitation of liability that applies to all damages of any kind, including, (without limitation), compensatory, direct, indirect or consequential damages, loss of data, income or profit, loss of or damage to property and claims of third parties.

Introduction

As a general rule the employer should operate PAYE on all earnings of its employees. Income tax and national insurance contributions ('NIC') are deducted at source from remuneration paid by the employer (salary, wages, bonuses, commissions etc) and on certain other payments that resemble monetary remuneration such as round sum allowances and loans written off. No employee NIC has to be paid if you are over the state retirement age. The employer pays employer NIC on all earnings.

Employers should be wary of paying people who work for them regularly as consultants – they may be considered employees by HMRC and the rules need to be carefully considered. An employer can be liable to pay tax and NIC on payments to consultants if they are found to have handled this incorrectly.

Employees are also subject to tax on other benefits they receive from their employer. These include benefits such as company cars and free medical insurance. The employer will be liable for class 1A NIC on most taxable benefits and the employee normally pays income tax on the benefits through amendment to their tax code. Some benefits are exempt from tax.

Charities can reimburse volunteers for expenses, but need to ensure that they do have a proper system and avoid round sum allowances.

1

Employed or self-employed

Where an organisation pays an individual to undertake work, the first thing to establish is the individual's employment status – are they employed or self-employed? The tests of employment status are derived from case law. It is the actual relationship between the parties that determines the employment status, rather than the legal form of any contract or the words used to describe the relationship. For a contract of employment to exist, two tests must both be satisfied:

- **The mutuality test**

The organisation must have an obligation to provide work and the individual must have an obligation to personally carry out this work. If the organisation has no obligation to provide work or the individual has no obligation to undertake work or can provide a substitute to undertake the work this indicates self-employment. However if none of these ever happen in practice or if substitutes must first be approved by the organisation, the indication may be weakened.

- **The control test**

The individual agrees, expressly or by implication, to be subject to the organisation's control. Control includes the power of deciding the tasks to be done, the way in which they are done, the means of doing them and the time and place where they are done. However, the degree of control will vary and in some cases, such as professionally qualified individuals, the courts have sometimes decided that an individual is an employee even though the actual control exercised is minimal.

The overall picture

If the tests are both met or are inconclusive, the next step is to consider all the circumstances. Factors that have been considered relevant by the courts include:

- who supplies any equipment required
- whether the individual hires any helpers
- the individual's degree of financial risk and opportunity for profit
- whether the individual is 'part and parcel' of the organisation
- whether the individual has a recognisable business infrastructure
- the degree of continuity in the relationship
- the number of other similar engagements entered into by the individual
- the intentions of the parties

However, a scorecard-type approach to assessing the overall picture is inappropriate as not all factors are of equal importance and the factors may vary in importance from one situation to another. Some HMRC guidance on employment status can be misleading in this respect, suggesting that all factors have equal weight.

Getting it wrong

If an individual is mistakenly treated as self-employed, the individual will assume the rights of an employee including the right to paid holidays, protection against unfair dismissal and the right to redundancy pay. The employer will also be liable for any income tax and national insurance that should have been paid in respect of the employee, assuming the payments to the employee were net of any tax due. Income tax and national insurance payments by the individual can, subject to conditions, be used to offset the employer's liability and, as a result, the employer will only be liable for any excess.

2

Unusual or irregular employment

Casual and temporary employees

It is a misconception to think that you can pay casual workers without operating PAYE. In most situations casual and temporary employees are taxed in the same way as permanent employees. A casual worker is someone taken on for less than a week and is the only time when a P46 is not required. Tax and NIC are still due if they earn over the thresholds.

Students

If students work for you in the holidays, you can just deduct NIC, providing their earnings remain below their personal allowance for the tax year.

Agency staff

Temporary agency staff ('temps') will usually be employees of the agency and the agency will be responsible for dealing with their PAYE and NIC. However, if the temp is in legal terms an employee of the agency's client or if the agency does not have a trading address or a representative in the UK, the agency's client must operate the PAYE and national insurance procedures.

Zero hours contracts and pool staff

Under a typical zero hours contract the employer is not obliged to provide work, the worker is not obliged to accept work and the worker is just paid for the actual hours worked. Zero hours contracts are common where a pool of workers is on call. Check first that the mutuality of obligation test is met and that they are employees. If, in practice, pool workers are always offered work and accept it, this suggests they are employees.

3

Special situations for national insurance contributions

Special rules apply to particular sectors or situations which the individuals are treated as employees for national insurance purposes only. These include:

- Teachers who teach in an educational establishment, except public lectures, or prior agreement that there will not be more than three days in three consecutive months.
- Entertainers including actors, musicians, singers and dancers if their remuneration includes a salary element. Salary here is defined as a payment that meets all of the following conditions:
 - it is made for services rendered
 - it is paid under a contract for services
 - there is more than one payment
 - it is payable at a specified period or interval
 - it is computed by reference to the amount of time for which work has been performed.

An entertainer who is paid a single fee for an entire production will escape these rules. Entertainers treated as employees for income tax purposes can claim a deduction for fees paid to their agent.

- Examiners, moderators, invigilators, question setters etc for examinations leading to any certificate, diploma, degree or professional qualification if the whole of the work is performed under a contract in less than twelve months.
- Cleaners of non-domestic premises if they personally perform the cleaning and are not an employee of a cleaning business.

4

Forms P11D for benefits and expenses

It is widely assumed that forms P11D only apply to taxable benefits, but in fact forms should be completed for all employees earning at a rate of £8,500 or more if you pay them taxable benefits or deductible expenses that are not covered by a dispensation. The expense payments may be tax deductible for the employee, who has to claim tax relief for them on their tax return. Such expenses should be incurred wholly, exclusively and necessarily in the performance of the duties of the employment. Necessarily means that every employee carrying out a similar task would have to incur expenditure of that type. Wholly and exclusively means that the expenditure does not have a dual business and non-business purpose. Note that travel between home and work is excluded. Professional membership fees are allowed where it is a requirement of the occupation.

Dispensations

An employer can obtain a dispensation from the need to report deductible benefits and expenses on a P11D. The employer must state the benefits to be covered by the dispensation and the circumstances in which they will be paid and monitored.

Taxable benefits

Some benefits will always be taxable such as company cars (notifiable on form P46 (car) and fuel provided by the employer for a company car that is available for private use. Private medical insurance and benefits provided above the tax exempt limits are taxable. If an employee pays towards any benefit arising that will reduce the tax liability.

Trustee expenses

Providing the expense claims amount to less than £8,500 per year, no P11D is required.

5 Special arrangements

Salary sacrifice

A salary sacrifice arrangement is one in which an employee gives up the right to remuneration in return for a benefit, for example to enhance pension contributions or obtain childcare vouchers. The employee and employer both save tax which can be put towards the benefit. For a salary sacrifice arrangement to be effective:

- The employment contract must be varied before entitlement to the benefit arises
- The result of the varied contract must be that the employee is entitled to lower remuneration and a benefit. If the employee can opt to switch back to the previous arrangement this may render the benefit taxable as it can be exchanged for cash.

Lower paid employees

A lower paid employee is one whose total earnings plus taxable and deductible benefits are at a rate that is less than £8,500 in a tax year. Lower paid employees are exempt from most of the benefit rules and any taxable benefits must be reported on a P9D rather than on a P11D. In particular the following benefit rules do not apply to lower paid employees:

- Expense payments to be declared for tax
- Rules on cars available for private use and private car fuel
- Beneficial loans in excess of £5,000.

Benefits that are taxable for lower paid employees include non-exempt employer-provided accommodation and vouchers such as travel, meal and childcare vouchers where these are not covered by the exemptions.

6

Exempt benefits

The following benefits are tax exempt and do not need to be reported on a P11D or covered by a dispensation:

- Approved mileage allowances paid to employees using their own car, van, motorcycle or bicycle for business travel. The rate for cars and vans is, from April 2011, 45p per mile for the first 10,000 miles and 25p per mile thereafter. The rate for motorcycles is 24p per mile and for bicycles 20p per mile. If a higher rate is paid the excess is taxable and if a lower rate is paid the employee can claim tax relief for the difference. Note that home to work commuting does not normally count as business travel.
- A pool car is made available to more than one employee for business use. Provided various conditions are met, any private use of the car that is incidental to business use does not give rise to a taxable benefit.
- Free or subsidised canteen meals 'on a reasonable scale' available to all employees at a particular location are exempt.
- Small beneficial loans are interest-free or low interest e.g. to purchase a season travel ticket. The total balance outstanding should be under £5,000.
- Employer pension contributions into an approved personal pension scheme.
- Relocation expenses up to £8,000 per move including bridging loan costs is exempt, but the excess is taxable.
- Workplace nurseries and childcare vouchers up to £55 providing all staff at a particular location are eligible and the childcare must be registered or approved. From April 2011 tax relief is restricted for higher and additional rate taxpayers.
- Living accommodation necessary for the proper performance of the

job or where customary to the job and improves the performance is exempt. Examples include full-time caretakers and on-call care staff. Council tax and water rates are then also covered. However, payment of gas, electricity, cleaning and other bills and the provision of furnishings and furniture give rise to a taxable benefit.

- One medical check-up per employee per year is exempt.
- Additional homeworking costs such as the costs of heating and lighting where an employee works regularly at home by agreement with the employer. HMRC accept that payments of up to £3 per week can be made without the need to keep supporting evidence. Higher rates may be paid if supporting evidence is obtained or if agreed with HMRC
- Incidental overnight expenses up to £5 per night for business journeys in the UK and £10 for journeys outside the UK where the employee is required to work away from home.
- Parking facilities at or near the employee's place of work.
- Employee bicycles and cycle safety equipment provided available to all employees and the main use of the equipment is for commuting or travel at work.
- Taxis for late night working up to 60 occasions per year provided irregular, the employee is required to work later than usual and until at least 9pm and by the time the employee ceases work public transport has ceased or it would not be reasonable to expect the employee to use it. This exemption will be abolished in 2012 subject to consultation.
- Annual parties and social events such as Xmas parties provided the event is open to all employees and costs no more than £150 per head.

Further exemptions include work related training, sporting and recreational facilities, equipment for disabled employees, equipment for business use, mobile phones and overseas medical insurance and treatment.

7

Termination payments

The taxation of payments and benefits made on the termination of employment is a complex topic and it is best to seek advice before making significant termination payments.

They should first be split into their component parts:

- **Fully taxable** If the component ‘arises from’ the employment or is paid in connection with a restrictive covenant then it is taxable in full. Arising from the employment means the payment has the character of earnings. Examples include pay arrears, bonuses, holiday pay and garden leave
- **£30,000 pot** If the component is not taxable in full but is received in connection with the termination of employment then all such components are taxable only to the extent they collectively exceed £30,000. No national insurance is due. Examples include statutory redundancy pay and most compensation payments made under compromise agreements.
- **Tax exempt** In a few special situations the component is completely tax exempt. Examples include payments made on account of the death, injury or disability of an employee.

Some particular problem areas are:

- **Payments in lieu of notice (PILONs)** PILONs are a complex area. If the contract of employment provides that the employer will make a PILON it will be taxable in full. In other situations the position is less clear cut and legal advice should be obtained.
- **Non-statutory redundancy payments** Most payments under non-statutory redundancy schemes will be accepted by HMRC as falling into the £30,000 pot, even if contractual. It is possible to seek advance clearance from HMRC for such schemes.



Volunteers

Charities may pay volunteer expenses such as:

- travel to and from home
- travel, subsistence and accommodation whilst on charity business
- childcare costs
- the cost of telephone calls and household expenses incurred on charity business.

Providing the charity does no more than reimburse the extra costs incurred by the voluntary worker they will not be taxable, do not need to be reported on a P11D or P9D and do not need to be covered by a dispensation. Some specific volunteer situations:

Round sum allowances

Round sum allowances may be regarded as remuneration for work done and therefore subject to income tax and national insurance. The volunteer becomes an employee for employment protection and minimum wage requirements and the volunteer's entitlement to state benefits may also be affected. Scale rate payments to reimburse incurred costs are permissible.

Mileage allowances

HMRC will accept that mileage allowances at the approved rates do not give rise to a tax liability. If higher rates are paid, the charity must be able to justify them on the basis that they reflect the actual cost to the volunteer. In such a situation it may be possible to agree with HMRC that higher scale rates can be paid to volunteers though HMRC will expect evidence to support any rates proposed.

9 Conclusions

Employment taxes present many potential problems for organisations:

- Deciding whether an individual is an employee or is self-employed may be difficult and the costs of making a mistake can be high
- Care is needed with casuals and temporary workers
- Charities in the education and entertainment sectors need to be aware of the special national insurance rules for lecturers, examiners and entertainers. All charities should beware of paying cleaners through petty cash.
- The benefit rules are complex and demanding. Many organisations are not aware that reimbursed expenses are a taxable benefit and need to be either reported on a P11D or covered by a dispensation
- Expense payments and benefits provided to trustees and volunteers need particular care. Round sum allowances should be avoided and scale rate payments should be designed so as to do no more than reimburse actual costs incurred
- Charities should obtain dispensations wherever possible in order to reduce the end of year administrative burden.

Further information

HMRC guide to expenses and benefits

www.hmrc.gov.uk/pay/exb.htm

HMRC employment status indicator

<https://esizcalculator.hmrc.gov.uk/esi/app/landing-page.html>

Application form for a dispensation

<http://search2.hmrc.gov.uk/kbroker/hmrc/forms/viewform.jsp?formId=3169>

HMRC guidance on PAYE settlement agreements

www.hmrc.gov.uk/pay/exb-intro-psa.htm

HMRC Employment income manual

www.hmrc.gov.uk/manuals/eimanual/index.htm

Foreign & Commonwealth approved subsistence rates

www.hmrc.gov.uk/employers/wwsr-aprilo8-revisions.pdf

Table of approved flat rate allowances for specified categories of employee

www.hmrc.gov.uk/manuals/eimanual/EIM32712.htm

made simple guides

Made Simple guides are aimed at finance professionals working in charities. They cover technical areas such as risk assessment, accounting, tax and VAT treatments and aim to provide practical guidance to busy accountants in charities.

The content of guides is correct at the time of going to print, but inevitably legal changes, case law and new financial reporting standards will change. You are therefore advised to check any particular actions you plan to take with the appropriate authority before committing yourself. No responsibility is accepted by the authors for reliance placed on the content of this guide.

Other guides in the series

Risk assessment made simple

Reserves policies made simple

Trading issues made simple

Subsidiaries made simple

VAT made simple

Grants and contracts made simple

Pricing made simple

Gift aid made simple

Tax effective giving made simple

