

Employee and volunteer taxation

made simple



April 2016

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Published by Sayer Vincent LLP

Chartered accountants and statutory auditors

Limited liability partnership registered in England and Wales
OC390403

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Introduction

As a general rule an employer should operate PAYE on all earnings of its employees. Income tax and national insurance contributions ('NICs') 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 NICs has to be paid if you are over the state retirement age. The employer pays employer NICs on all earnings.

Employers should be wary of paying individuals who work for them regularly and in a similar way to an employee – they may be considered an employee by HMRC and the employment status rules need to be carefully considered. An employer can be liable to pay Income Tax and NICs on payments to contractors if they are found to have handled this incorrectly.

Employees are also potentially subject to Income Tax and NICs on other benefits in kind they receive from their employer. These include benefits such as company cars and free medical insurance. The employer will be liable for class 1A NICs on most taxable benefits in kind 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.

Employed or self-employed

Where an individual is paid to undertake work, the first thing to establish is the whether or not the individual is employed or self-employed. This is referred to as determining the individual's 'employment status'.

If an individual claims to be providing their services via an intermediary, such as via a personal service company, then see the section on IR 35 below.

Employed or self-employed status attaches to a particular contract and not to the individual carrying out the work. The same individual might be self-employed under one contract and employed under another.

The HMRC website provides an Employment Status Indicator tool ('ESI') that may be able to give assurance in such situations – see the section on HMRC ESI Tool below.

Status tests

The starting point for applying the status tests is the engagement contract together with any other documentation that sets out the terms of the contract, such as a job description, staff handbook or union agreement. However, written engagement terms can be ignored if they do not correspond to reality, for example, because of mistakes or because sham clauses are inserted to disguise an engagement's true status.

For a contract between a contractor and a worker to be a contract of employment, all three of the following conditions must be satisfied:

1 Mutuality of obligation and personal service

The contractor must have an obligation to provide work to the worker and the worker must have an obligation to personally carry out this work. If the worker has a genuine right to provide a substitute to undertake the work, then this test fails and the worker is self-employed. It is not necessary for the worker to have exercised such a right. However, if a written right to provide a substitute does not exist in reality, the written right can be ignored.

2 Control

The worker agrees, expressly or by implication, to be subject to the contractor's control. Control means the power of deciding:

- what tasks are carried out
- the way in which they are carried out
- the means of doing them
- the time and place where they are done.

All four factors must be present for control to exist, however the degree of control necessary to satisfy the test may vary and in some cases, such as professionally-qualified individuals, the degree of control necessary to satisfy the test can be low.

3 Other terms

The other provisions of the contract must be consistent with its being a contract of employment. Other factors that are commonly used to assess this include:

- who provides any equipment or materials required
- the worker's degree of financial risk and opportunity for profit
- whether the worker is 'part and parcel' of the organisation

- whether the worker has a recognisable business infrastructure
- the degree of continuity in the relationship and the length of the engagement
- the number of other similar engagements entered into by the worker
- the way the worker is remunerated (for example inclusion of sick pay and/or holiday pay is usually seen as indicative of employment)
- the intentions of the parties.

A scorecard-type approach to assessing the third test is inappropriate as not all factors are of equal importance and the factors may vary in importance from one situation to another. One must stand back and examine the overall picture.

If any of the tests fail, the worker is self-employed.

HMRC ESI Tool

The Employment Status Indicator (ESI) tool enables you to check the employment status of an individual or group of workers. However, the tool cannot be used for IR35 situations, agency workers and company directors. HMRC state:

When you have answered all the questions, the ESI tool will provide its indication of the worker's employment status. You can rely on

the ESI outcome as evidence of a worker's status for tax/NICs/VAT purposes if both of the following apply.

- Your answers to the ESI questions accurately reflect the terms and conditions under which the worker provides their services.
- The ESI has been completed by an engager or their authorised representative (if the tool has been completed by or on behalf of a worker the result is only indicative).

However, you should download and print or save the PDF bearing the 14 digit ESI reference number from the summary of outcome screen. If the worker's employment status is questioned in the future, HMRC will only be bound by the ESI outcome if this document can be produced.

Getting it wrong

If an individual is mistakenly treated as self-employed, the individual may 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 PAYE and national insurance that should have been paid in respect of the employee, assuming the payments actually made 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.

Special situations

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.

The special agency rules can apply to voluntary organisations themselves if they provide workers who personally provide services and the manner in which that worker provides the services is subject to a right of supervision, direction or control by any person. In this scenario the worker can be treated as an employee of the provider, though services of actors, musicians, singers, entertainers, and models are excluded as are services provided in the worker's own home or at other premises which are neither controlled or managed by the client nor prescribed by the nature of the services.

In addition special intermediaries anti-avoidance legislation treats as employments certain arrangements under which workers are provided to clients by intermediaries and the worker would, if under contract directly with the client, be an employee of the client.

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. If the contract guarantees a minimum number of hours, HMRC are likely to see it as a contract of employment if the other employment tests (control and other terms) are satisfied.

IR 35

The IR35 rules are designed to prevent individuals from using intermediary business structures to avoid or reduce their income tax and NIC liabilities. Typically individuals set up personally- or family-owned companies through which they provide their services. The intermediary company invoices for the individual's services on the basis it is the entity which is supplying them, not the individual. The company then usually passes on some or all of the fees to the individual in the form of dividends.

The IR35 legislation requires the intermediary entity to pay income tax and NICs on all income from a contract if that contract would be a contract of employment but for the interposition of the intermediary. The IR35 rules target the intermediary entity and engagers can pay the intermediary's invoices without deduction of income tax or NICs.

Employee benefits and expenses

If an employer reimburses an employee's expenses, for example reimbursement of business travel costs, or if an employer provides a benefit for an employee, for example providing use of a company car, those 'reimbursed expenses' and 'benefits in kind' are potentially treated as earnings for the employee and/or employer. For benefits in kind there are rules as to how the cash equivalent of the benefit is calculated.

Expenses are amounts paid to or put at an employee's disposal to cover costs incurred by the employee. Benefits include use of employer-owned assets, and payments by an employer directly to a third party to pay for employee benefits, for example payments for hotel accommodation using a company credit card.

The types of benefit and reimbursed expense

Benefits and reimbursed expenses can be divided into three types

Exempt: the benefit or expense is exempted from income tax and NICs and does not have to be reported to HMRC. See below for a list of exempt benefits and expenses.

Deductible: with effect from 6 April 2016, certain benefits and expenses are exempt if not provided under a 'salary sacrifice arrangement' and taxable if provided under salary sacrifice.

Taxable: the benefit or expense is subject to income tax and/or NICs and must either be treated as earnings and added to the payroll or reported to HMRC on a P11D and/or on a P11Db end of year return.

Taxable benefits and expenses

Some benefits will always be taxable such as company cars 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 also taxable. If an employee pays towards any benefit arising that will reduce the tax liability.

Taxable reimbursed expenses must be included in the payroll and subject to Income Tax and class 1 NICs when paid.

From 6 April 2016, taxable benefits in kind must either be:

Reported on an end of year P11D return and listed on a P11Db. One P11D must be submitted for each employee who received taxable benefits in the tax year. The P11Db is a return of all benefits which are subject to employer's class 1A NICs.

'Payrolled' by being added to the payroll.

The benefit is subject to Income Tax but not class 1 NICs. Payrolled benefits do not have to be reported on a P11D but must be included on the P11Db return if subject to class 1A NICs. From 6 April 2016 employers can choose to payroll most types of taxable benefit in kind however they must elect to do so before the start of the tax year (6 April). All types of taxable benefit in kind can be payrollled except for vouchers and credit cards, living accommodation and interest-free and low-interest (beneficial) loans, though at Budget 2016 the government announced it would allow payrollling of non-cash vouchers and credit tokens from 6 April 2017.

Exempt benefits and expenses

The following benefits are tax exempt and do not need to be reported on a P11D.

- 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.
- A pool car that 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.
- Small beneficial loans are interest-free or low interest, for example, to purchase a season travel ticket. The total balance outstanding should be under £10,000. The limit before 6 April 2014 was £5,000.
- Employer pension contributions into an approved personal pension scheme.
- Relocation expenses up to £8,000 per move including bridging loan costs are exempt, but any 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. 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.
- 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 £4 per week (£3 up to 5 April 2012) 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 they are irregular, the employee is required to work later than usual and until at least 9.00 pm 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.
- Annual parties and social events such as

Christmas parties provided the event is open to all employees and costs no more than £150 per head (including VAT).

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.

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 obtain enhanced pension contributions or to obtain childcare vouchers. This can allow the employer and/or the employee to reduce their tax liabilities. Many employers give all or part of their NIC saving back to the employee, with the result the employee gets more for the same cost to the employer.

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, however, HMRC accepts this can be done for major life events such as: redundancy of a partner, pregnancy of employee or partner, marriage or divorce of employee or if an event happens that means the salary sacrifice arrangements are no longer suitable.

Deductible benefits and expenses

From 6 April 2016 deductible benefits and expenses are exempted if not provided under salary-sacrifice arrangements and taxable otherwise. These include:

- expenses incurred wholly, exclusively and necessarily in the performance of the duties of the employment
- travel and subsistence costs incurred, in the performance of the duties of employment, in respect of travel for the employee's necessary attendance at any place in the performance of the duties of employment, and certain foreign travel (excludes most home-to-work travel)
- subscriptions to certain professional bodies – see HMRC List 3 for bodies to which HMRC accept subscriptions can be treated as deductible
- certain household expenses of ministers of religion (see page 12)
- certain agency fees paid by entertainers.

Meal allowances

Employers can choose to reimburse employees for meals taken whilst on business travel as follows:

- On the basis of exact reimbursement, for example by the employee obtaining receipts which are then claimed for.
- By using the benchmark rates as set out below. There is no requirement for the employee to retain receipts however, the employer must operate a system for checking that employees are in fact incurring and paying amounts in respect of the amounts claimed.
- The employer can agree a bespoke scale rate with HMRC based on a sampling

exercise. When agreed the bespoke rates last for 5 years.

Benchmark rates for meal allowances

For foreign travel, HMRC provide a list of benchmark rates that can be used for travel in particular states and cities/regions around the world.

For UK travel, with effect from 6 April 2016, one meal allowance per day can be paid in respect of one instance of qualifying travel, provided it does not exceed:

- a £5 where the duration of the qualifying travel in that day is 5 hours or more
- b £10 where the duration of the qualifying travel in that day is 10 hours or more
- c £25 where the duration of the qualifying travel in that day is 15 hours or more and is ongoing at 8.00 pm on that day.

An additional meal allowance not exceeding £10 can be paid where a meal allowance in paragraph (a) or (b) is paid and the qualifying travel is ongoing at 8.00 pm on that day.

Trivial benefits

HMRC has long accepted that certain benefits can be regarded as trivial and ignored for tax purposes. These include seasonal flu immunisation jabs, tea and coffee provided to employees and small gifts made in recognition of a particular event such as an employee's marriage or birth of a child, or a seasonal gift, such as a turkey, an ordinary bottle of wine or a box of chocolates at Christmas.

This practice has been put on a statutory basis with effect from 6 April 2016 when an exemption was introduced for any benefit in kind provided to an employee that meets all four of the following conditions:

- 1 The benefit is not cash or a cash voucher, (however retail vouchers are acceptable).
- 2 The 'benefit cost' of the benefit does not exceed £50. 'benefit cost' means the cost of providing the benefit to the employee, or if the same benefit is provided to more than one employee, the average cost.
- 3 The benefit is not provided under a salary sacrifice or under any contractual obligation.
- 4 The benefit is not provided in recognition of particular services performed by the employee in the course of the employment or in anticipation of such services.

If the employer is a 'close company', and the employee is a person who is a director or other office-holder of the employer, or a member of the family or household of such a person, then the benefit cost of all benefit provided to the employee in a tax year must not exceed £300.

Ministers of religion

Ministers of religion attached to a place of worship or to a congregation are subject to two special regimes for benefits and expenses.

- 1 If they pay rent for a dwelling house and part of the house is used mainly and substantially for the performance of religious duties, they can claim a deduction of 25% of the rent, or if less, a just and reasonable apportionment of the rent for that part of the house.
- 2 If an interest in premises is held by a charity or ecclesiastical corporation, and a minister of religion has a residence in those premises from which to perform their religious duties, then the minister

can claim a deduction for 25% of the expenses borne by the minister on the maintenance, repair, insurance or management of the premises.

Lower-paid ministers of religion

Lower-paid ministers of religion obtain a special exemption for certain accommodation-related and other expenses and benefits. 'Lower paid' means the minister of religion's earnings are at a rate of at most £8,500 per tax year.

The payment of, reimbursement of or provision of an allowance to cover certain accommodation outgoings is an exempt benefit. 'Accommodation outgoings' means an amount incurred by the minister in heating, lighting, or cleaning qualifying premises or in maintaining a garden forming part of the premises.

Director and trustee expenses

An 'office' is a position that has an existence that is independent of the person who holds it, for example company directors and charity trustees. Office holders can be treated as employees receiving employment income in respect of payments they receive in respect of that office. As a result expenses payments to unpaid directors and trustees of voluntary organisations can be caught by the employee benefit rules. However, travel expenses paid or reimbursed to an unpaid director of a not-for-profit company are exempt. This includes travel to and from home. The trustee or director must be obliged to incur the expense as holder of the office and the expense must be attributable to the trustee/director's necessary attendance at any place in the performance of the duties of the office.

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.

Termination payments 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. Examples include arrears of pay, bonuses, holiday pay and garden leave salary.

£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 damages 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 can be less clear cut and legal advice should be obtained.

Non-statutory redundancy payments

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.

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 NICs. The volunteer becomes an employee for employment protection and minimum wage requirements and the volunteer's entitlement to state benefits may also be affected. However, scale rate payments that are calculated so as to do no more than reimburse costs incurred may be permissible.

Honoraria

If an officer is paid a flat-rate honorarium to cover out-of-pocket expenses then this risks being seen as earnings for the officer concerned. It may be better to structure payments for expenses as scale rate payments, calculated so as to do no more than reimburse actual costs incurred.

Mileage allowances

HMRC will normally accept that mileage allowances incurred by volunteers in carrying out their duties at the approved rates (see *Exempt benefits and expenses* above) do not give rise to a tax liability. This includes

home-to-work travel. 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.

Benchmark meal rate

HMRC may be prepared to accept that the benchmark meal rates for employee business travel (see page 11 *Meal allowances*) can be adapted to apply to volunteers.

Conclusion

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.
- 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 as based on empirical evidence.

Further information

HMRC guide to expenses and benefits

www.gov.uk/government/publications/480-expenses-and-benefits-a-tax-guide

HMRC employment status indicator

<http://tools.hmrc.gov.uk/esi/screen/ESI/en-GB/summary?user=guest>

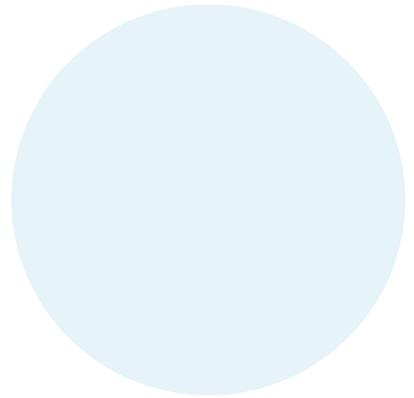
List 3 bodies

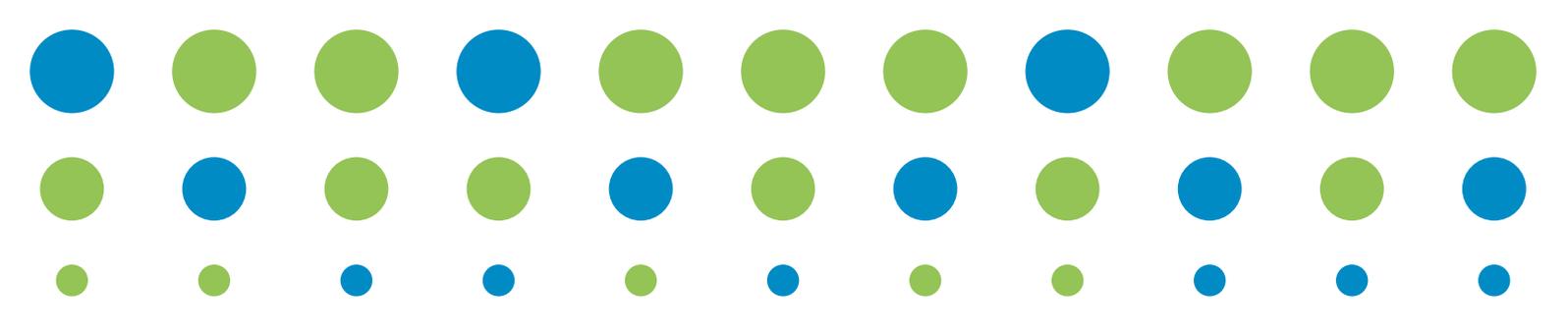
www.gov.uk/government/publications/professional-bodies-approved-for-tax-relief-list-3

HMRC Employment income manual

www.gov.uk/hmrc-internal-manuals/employment-income-manual

Notes





Made simple guides

Made Simple guides are aimed at finance professionals and other managers working in charities. They cover technical areas such as tax and VAT treatments as well as information management areas and aim to provide practical guidance to busy managers and trustees in charities.



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