KEY GUIDE

Making the most of fringe benefits

Why should you consider fringe benefits?

A fringe benefit is essentially any type of non-monetary compensation provided to an employee or director, and can be anything from pension provision to medical cover, a company car or the use of a company yacht. The tax rules for fringe benefits change frequently, so it is important to use up-to-date information and plan ahead. Just because a benefit is, or is not, tax efficient this tax year, the situation may change in the future. For example, recent changes include an increase to the percentage surcharge applied to diesel company cars and the introduction of an exemption for employer-provided pension advice.

As a director, there might be a tax advantage to taking a benefit rather than the additional income needed to purchase the benefit yourself. As an employer, you will be looking to use fringe benefits to attract, reward and retain employees. Benefits can be provided on top of normal salaries, or they may be provided as part of a salary sacrifice arrangement.

Some fringe benefits are completely free of tax, whilst some benefits are free of national insurance contributions (NICs) as far as employees are concerned. As an employer, you may well be able to acquire some benefits, such as medical cover, at a discount on what an employee would have to pay for the benefit personally.

Planning point

Consider making use of a specialist benefits provider because this will remove your administrative burden and give your employees access to a wide choice of benefits that can be selected to suit their lifestyle.

Tax treatment

All employees (with certain exceptions) are treated the same when it comes to the taxation of fringe benefits.

Employees are generally taxed on what it costs to provide the benefit. If medical insurance costs £1,250 a year per employee, then that is the figure each employee will be taxed on. If you or an employee simply has the use of an asset, such as a laptop, then the taxable benefit is calculated as 20% of the asset's value when first provided. Of course, the asset might be rented, and in that case the rental figure will be used if higher.

However, there are special computational rules for certain fringe benefits, such as company cars, fuel provided for private use and cheap loans. The amount of taxable benefit is proportionately reduced where a benefit is only available for part of a tax year, and any amounts paid towards the benefit (by you, as a director, or an employee) will reduce the taxable figure.

Unless tax free, benefits are subject to income tax at an employee's marginal rate (20%, 40% or 45%), with tax normally collected under Pay As You Earn (PAYE). Although there are generally no employee NICs on fringe benefits, you, as the employer, will have to pay Class 1A NIC at the rate of 13.8% on all taxable benefits. The costs of providing employee benefits will usually be deductible in calculating your taxable profits, either as an expense or as capital allowances if you purchase something such as a company car.

Salary sacrifice

From 6 April 2017, most of the tax and NIC advantages of many salary sacrifice arrangements have been removed. However, this change does not apply to pension contributions, childcare, low-emission cars or health-related benefits such as cycling to work. Transitional rules apply to arrangements that were in place prior to 6 April 2017.

Salary sacrifice is where an employee gives up a portion of their salary in return for a fringe benefit. The arrangement obviously works best where the benefit is tax free, and will typically involve one not affected by the recent changes such as pension contributions or childcare vouchers. There will be little or no additional cost for you in providing such benefits under a salary sacrifice arrangement, but there are tax advantages all round.

Within set limits, employer pension contributions can be made on behalf of an employee free of tax and NICs, and it does not matter whether contributions are to a company scheme or to a personal pension scheme.

Example – Salary sacrifice using pension contributions

Joan, one of your employees, has a gross salary of £30,000 and is personally making pension contributions of £2,000. Although income tax is only paid on £28,000 (£30,000 – £2,000), NICs for both you and Joan are based on the full £30,000. Under a salary sacrifice arrangement, Joan could give up £2,000 of her salary, with you then making the £2,000 pension contributions. The tax position is unchanged, but NICs would then be calculated on the lower salary of £28,000 – particularly beneficial here because Joan saves NICs at the 12% rate.

Planning point

Ensure that contractual arrangements are watertight so that employees are not able to swap between salary entitlement and fringe benefits whenever they like. Otherwise, the salary sacrifice arrangement will not be valid.

Being able to take 25% of the pension fund tax-free from age 55, with total withdrawal flexibility for the remainder of the fund, simply enhances the arrangement. The basic idea works equally well for you as a director, because pension contributions can be paid rather than drawing profits as remuneration or dividends.

The same principle applies with childcare vouchers where employees can be given tax-free vouchers of up to £2,916 per parent each year to help with their childcare costs. However, the childcare voucher scheme will not be available to new entrants from 6 April 2018.

Social benefits

Benefit packages increasingly include a range of social benefits focused on health care, childcare, eldercare and green issues. There can be a fine line between those benefits which are tax-free and those which are taxable.

Your employees can make use of a company gym without any tax implications, whether it is provided free or at a subsidised price. You can also provide healthy food in a company canteen. However, if you pay for a fitness club membership or provide a dining card there is a taxable benefit. You can provide tax-free annual health checks, counselling and eye tests (where an employee is required to use a computer), but medical insurance and medical treatment will normally be taxable. There is an annual exemption of up to £500 where you pay for medical treatment to help an employee return to work following sickness or injury.

You can provide your employees with a nursery or child-minding facilities on a tax-free basis but, except for the limited childcare voucher exemption (and a similar limited exemption for directly contracted childcare), any other childcare support you provide will be taxable. The same applies if you provide financial support to employees that care for elderly parents (eldercare). However, you can assist your employees with both childcare and eldercare by offering flexible working and working from home – neither of which will result in any benefit implications. You can pay a tax-free amount of up to £4 a week towards the additional costs an employee incurs from working at home.

Cycling to work can be encouraged by providing employees with tax-free bicycles and safety equipment, with the employee having the opportunity to purchase the bicycle at a fair market value following the end of the loan period. Bicycles and safety equipment are often provided under a salary sacrifice arrangement. You can also arrange for employees to have cheap or free travel on public bus services, or even go as far as providing a free work bus. However, the provision of a transport pass that covers a wide area (such as the London Oyster card) will not be tax-free.

Car benefits

The company car will often be the first thing that comes to mind when the subject of fringe benefits comes up, but this traditional company perk can easily be very tax inefficient. What is often overlooked is that a car's age and cost are irrelevant when it comes to calculating the taxable benefit, as is the amount of business mileage.

The taxable benefit for a company car is calculated as a percentage of the car's list price, with the percentage determined by the level of carbon dioxide (CO_2) emissions. The use of list price means that any discount on the purchase price is ignored, and that the same value continues to be used even when a car is several years old. It makes no difference whether a car is bought outright or leased.

The car benefit covers all of all the costs associated with having a car such as insurance and repairs, but not fuel for private motoring.

When it comes to CO_2 emissions, modern hybrid cars generally have much lower rates compared to petrol and diesel variants. Plug-in hybrid variants have particularly low emission rates.

Action point

If possible, make sure that the conditions for tax-free status are met. The requirements can be quite strict, with the benefit normally having to be available to your entire workforce.

Example – Company car choice

Zoe, a director, is provided with a new company Mercedes C class Sport Auto costing over £39,000. Alex, a trainee salesman, is provided with a five-year old Ford Mondeo worth around £4,000. Zoe pays tax at 40% and does minimal business mileage, whilst Alex is a basic rate taxpayer and drives over 20,000 business miles annually. Rather surprisingly, Zoe's tax cost (despite paying double the tax rate) could well be less than that of Alex. This is on the basis that Zoe chooses the plug-in variant of the Mercedes C class, which has a low emissions rate – it even comes with a top speed of 155 mph and 0-60 acceleration in 5.7 seconds!

An employee can contribute up to £5,000 towards the cost of a company car, with this being deducted against the list price. It might be worthwhile making such a contribution if it means that a car with much lower emissions could be obtained than otherwise would be the case - hybrid variants typically costing a few thousand pounds more than normal variants.

For 2017/18, the percentage used is on the following scale:

- 9% where a car's CO_2 emissions do not exceed 50 g/km.
- 13% for emissions between 51 and 75 g/km.
- 17% for emissions between 76 and 94 g/km.
- An 18% rate applies at 95 g/km, rising in 1% steps for each additional 5 g/km.
- The percentage charge is capped at a maximum of 37%.
- A surcharge of 3% is applied to diesel cars (but not diesel hybrids), subject to the maximum percentage of 37%. From 2018/19, the surcharge will increase to 4% unless a diesel car is certified to the Real Driving Emissions 2 (RDE2) standard.

Company car percentages are due to increase substantially over the coming years, with, for example, the 9% rate increasing to 13% next year, then to 16% by 2019/20 – nearly doubling the rate. However, from 6 April 2020, the electric range of ultra-low emission cars will also be taken into account, resulting in substantial percentage reductions for cars that can travel a high distance on just electric power. A 2% charge will be introduced for cars that can only be driven in zero-emission mode.

Planning point

Make sure you carefully consider the tax cost and other factors before opting for a company car – throughout the entire period of use, not just for the current year. Unless you opt for a low-emission car (especially hybrid and plug-in hybrid variants) it may be the case that taking additional remuneration or dividends, and then buying or leasing a similar car personally, is a more tax-efficient option.

Fuel

Where any fuel is provided for private motoring, there will be an extra taxable benefit. This is calculated using the same percentage as for car benefits, but based on a fixed value, which for 2017/18 is £22,600. Unlike other benefits, where an employee's contributions automatically reduce the amount of benefit, there is no reduction for contributions towards the cost of private fuel unless the entire cost is reimbursed. It will often be beneficial to avoid the tax cost of a fuel benefit by paying for all private fuel, especially where the amount of private fuel is quite low or the car has high CO_2 emissions.

There is no fuel benefit for all-electric company cars because electricity is not classed as a fuel, even if a car's battery is charged at work.

Cheap loans

You might make cheap or interest-free loans to employees, maybe for them to purchase a season travel ticket or to buy their own car. The good news is that tax is not charged where the value of loans provided to an employee does not exceed £10,000 at any point during the tax year. However, if the £10,000 limit is exceeded by just a few pounds, then the exemption does not apply.

Where loans are taxable, the benefit is calculated as the difference between the amount of interest at HM Revenue & Customs' (HMRC) official rate, and the amount of interest actually paid. For 2017/18, the official rate is 2.5%.

Example – Cheap loan benefit

On 6 April 2017, Jones Ltd made a £15,000 loan (with an interest rate of 1.5%) to an employee who wanted to buy a car, with £5,000 being repaid by 5 April 2018. The average amount outstanding throughout 2017/18 is £12,500, so the taxable benefit is £125 (£12,500 x 1% (2.5% – 1.5%)). The benefit for 2017/18 could have been avoided if the interest rate charged had been set at 2.5%, although in any case there will be no benefit for 2018/19 given the £10,000 limit.

Be careful of relying on the £10,000 limit if you are also a company shareholder. In this case, a loan or an overdrawn director's current account could result in a tax charge for your company, with this charge applying whatever the amount of loan.

Other exempt benefits

Planning point

Don't forget that each year you can spend up to £150 per person for a Christmas party or similar function without any tax implications. Or you could throw two or more events provided the total per person cost does not exceed £150.

The most common benefit not already mentioned is the provision of a mobile phone for private use. You and each employee are permitted one tax-free mobile phone, but make sure that it is the company that owns the phone and takes out the contract with the telecoms company. A second phone will be taxable, as is any other device such as a tablet or laptop, even if they have telephone functionality. Mobile phones used solely for business, or with insignificant private use, are always exempt.

- Employees can be provided with a parking space for a car, motorcycle or bicycle.
- You can reimburse up to £8,000 of a new employee's moving costs if they have to move house to take up employment with your company.
- Employees can be provided with up to £500 of pension advice each year.
- There is also an exemption (with certain exceptions) for trivial benefits which do not cost more than £50 per employee.

How you should report benefits

Form P11D is used to report details of benefits to HMRC each tax year. Unless benefits have been payrolled (see below), you will have to complete a form P11D for each employee that you provide with benefits, although most payroll software will include P11D completion together with electronic submission to HMRC. An alternative is for you to use HMRC's online end of year expenses and benefits service which can deal with up to 150 employees. For 2017/18, P11Ds must be submitted to HMRC by 6 July 2018, with a copy given to the employee.

Form P11D(b) is used to declare the overall amount of Class 1A NICs due on taxable benefits provided during the tax year, and again this will normally be submitted electronically via your payroll software. The submission deadline is the same as for the P11Ds, although you have until 22 July 2018 to make the Class 1A NIC payment, provided this is done electronically.

On form P11D, you must also report any expenses paid to yourself or to employees which are not for business purposes. Expenses paid for business purposes are exempt and do not need to be reported.

The only in-year reporting required is with respect to company cars. Payroll software will handle the reporting requirements, and it is necessary to report when a car is provided, when there is a change of car or if a car is no longer provided. Reporting is on a quarterly basis.

The advantage of payrolling

As far as you or your employees are concerned, any tax due on taxable benefits will usually be collected under PAYE by a reduction to the tax code. However, the end of year reporting of most benefits means that some tax will invariably end up being collected by way of an HMRC tax calculation (with the underpayment leading to a tax code reduction) or via the submission of a self-assessment tax return. There will then be an element of double collection, with tax for more than one year being collected at the same time.

Planning point

If you want to payroll benefits for 2018/19 (it's too late to register for the current year), then you must register with HMRC well in advance of 6 April 2018. Registration is done using the payrolling benefits and expenses online service.

This problem can be avoided by payrolling benefits. With payrolling, taxable benefits are put through your payroll on a current basis in the same way as cash earnings. Any benefits which have been payrolled do not need to be included on P11Ds. With certain exceptions, all benefits, including company cars, can be payrolled. You can choose which benefits to include and any employee who does not wish for their benefits to be payrolled can be excluded. The payrolling of company car benefits will mean that in-year reporting is not required.

PAYE settlement agreements (PSAs)

An employee will no doubt be very pleased if you provide a ticket for a concert or sporting event, but less so when it comes to paying the related tax bill. For some benefits, it is possible for you to take care of the tax bill on the employee's behalf using a PSA. Of course, it means paying the tax on a grossed up basis (the tax paid is also a benefit) using the employee's marginal income tax rate. So, if the ticket cost £180 you will have to pay tax of £120 (£180 x 40/60) for a higher rate taxpayer.

A PSA can generally only be used for small or irregular taxable benefits, but can be useful if you want to encourage employee participation in a company event without them suffering any tax consequences.

How we can help

We can advise you how different fringe benefit packages will impact on both you and your employees.

If we are not already looking after your P11D reporting, then we are more than happy to take this on or to provide guidance if you continue to do so yourself. We can also help if you decide to payroll benefits.

There are frequent changes to the fringe benefit taxation rules, but we can keep you up to date well in advance of changes taking effect.

Nunn Hayward LLP
Chartered Accountants and Chartered Tax Advisors

Sterling House, 20 Station Road, Gerrards Cross, Buckinghamshire SL9 8EL
T 01753 888211 F 01753 889669
E mail@nhllp.com

W www.nhllp.com