These notes refer to the Finance Act 2015 (c.11) which received Royal Assent on 26 March 2015

FINANCE ACT 2015

EXPLANATORY NOTES

INTRODUCTION

Section 11: Exemption for Amounts Which Would Otherwise Be Deductible

Summary

1. This section introduces a new exemption for expenses which are paid or reimbursed by an employer where the employee would be due a deduction under Chapters 2 or 5 of Part 5 of the Income Tax (Earnings & Pensions) Act 2003 (ITEPA). It also provides an exemption in respect of benefits treated as earnings under the benefits code for which there is a deductible amount under Chapter 3 of Part 5 ITEPA. The legislation came into force on 6 April 2016.

Details of the Section

2. Subsection (1) introduces new Chapter 7A to Part 4 of ITEPA (Employment Income: Exemptions).

3. New section 289A(1) provides an exemption for the amount of paid or reimbursed expenses which would be treated as earnings under the benefits code under circumstances where a deduction would otherwise be due under Chapter 2 or 5 of Part 5 ITEPA. An example of a deductible expense are costs necessarily incurred in travel for the performance of an employee’s duties. The exemption will not apply if the payment or reimbursement is offered in conjunction with a relevant salary sacrifice arrangement. Relevant salary sacrifice arrangements for paid or reimbursed expenses are defined in new section 289A(5).

4. New section 289A(2) provides an exemption for payments of amounts in respect of expenses that are calculated in an “approved way” (commonly known as ‘scale rate’ or ‘flat rate’ payments). An “approved way” for these purposes is defined in new section 289A(6). This requires that sums are calculated and paid either in accordance with regulations made by the Commissioners for Her Majesty’s Revenue and Customs (HMRC) under that section, or in accordance with an agreement made under new section 289B. New section 289A(7) enables the power in new section 289A(6) to be used to make provision for different circumstances.

5. The exemption in new section 289A(2) will only apply if the payment is not provided as part of a relevant salary sacrifice arrangement, and if conditions A and B are met, which are defined in new sections 289A(3) and 289A(4) respectively. Condition A is that the employer, or a third party, must have a system in place to check that the employers’ employees are actually incurring expenses of the same kind, and that they are deductible. Condition B prevents the exemption applying if an employer or third party operating a checking system knows or suspects (or could not have reasonably been expected to know or suspect) that the employee is either not incurring the expense or that the expense is not deductible.

6. New section 289B introduces provisions for applying for approval to pay a flat rate in respect of deductible expenses. This includes, in new section 289B(2) the employer's requirement to provide a reasonable estimate of the actual costs incurred. The flat rate may only be paid if an officer of HMRC approves the application and issues an approval notice as provided for in new section 289B(3). New sections 289B(4) and (5) specify what that notice should or may contain.

7. New section 289B(6) provides that HMRC may specify what information is required and how it is to be set out in an application.

8. New section 289C introduces provisions for revoking approvals. Under new section 289C(2) the revocation notice may revoke approval for the use of the flat rate from the date of the approval notice or from a later date, for example, if the original circumstances of the application had been correct for a period of time before changing. New section 289C(3) sets out that the revocation notice may apply to all expenses or only specified expenses. New sections 289C(4) and (5) set out the effect of the revocation in respect of any tax liability and reporting requirements which arise as a result.

9. New section 289D introduces an exemption for benefits in kind (including vouchers and credit tokens) which the employee would otherwise have been entitled to a deduction for under chapter 3 of Part 5 ITEPA. The exemption will not apply if the benefit is offered in conjunction with a relevant salary sacrifice arrangement, the definition of which is provided for in new section 289D(2).

10. New section 289E introduces a targeted anti-avoidance rule which prevents the exemptions in section 289A and section 289D from applying to expenses payments and benefits in kind which are given as part of certain types of arrangements. An arrangement is caught by this rule if it reduces the amount of General earnings or Specific employment income of the employee subject to tax and National Insurance contributions and one of the main purposes of the arrangement is to avoid tax or National Insurance contributions. New section 289E(6) defines "arrangements" for the purposes of new section 289E.

Background Note

11. Unless an employer holds a dispensation from HMRC, the value of deductible expenses and benefits which are paid or reimbursed by an employer have to be reported on form P11D – employees can then claim for tax relief on that expense and/or benefit. This leads to unnecessary administrative burdens for employers and employees, and processing costs for HMRC where there is no tax to collect.

12. In response to recommendations from the Office of Tax Simplification as part of their general review of employee benefits and expenses, an exemption was introduced with effect from 6 April 2016 for paid or reimbursed deductible expenses and benefits. The effect of this legislation is that there is no longer any reporting requirement on employers, and employees will automatically receive the tax relief they are entitled to. In addition, there will be no need for dispensations once the exemption becomes effective.

13. This legislation introduces the necessary changes for income tax. Changes will be made to National Insurance contributions (NICs) legislation to mirror aspects of this change for payments that are subject to Class 1 NICs where necessary. For benefits which fall within a liability for Class 1A NICs, current Class 1A NICs legislation automatically mirrors the tax position.