PAYROLL BRIEFING

MARCH 2022

PAYROLLING OF BENEFITS IN KIND - TO DO OR NOT TO DO

What is it?

The payrolling of benefits was introduced in April 2016 as a simplification of the reporting, and taxation thereon, of benefits provided to employees. Over the years it has been rumoured that this will become a compulsory way of reporting and taxing benefits, but is still to be introduced and hence remains a voluntary process for employers.

As the name suggests, benefits provided to employees are reported via the payroll and taxed on a real time basis. This avoids the need to prepare individual P11Ds at the end of the tax year and ensures employees have paid income tax on the benefits at the time they are enjoyed.

Process to apply

Applications to payroll benefits must be made to HMRC on or before the start of the tax year in which the employer wishes to commence this system. If this approach is to be commenced, it is recommended that an application is made in good time before the start of the tax year to enable HMRC to update the employees' tax codes. This will mean that the estimated benefits reducing the employees' personal allowance through their tax code are removed.

Once the employer has applied to payroll certain benefits, this must continue for the whole tax year, subject to some exceptional circumstances. It is possible to exclude certain employees, if they do not wish to have their benefits taxed this way, and not all categories of benefits provided need to be included, although if certain benefits are excluded, some of the advantages of undertaking this approach are lost.

Once registered, HMRC will assume that benefits will be payrolled in future years; a formal application must be made, before the start of the next tax year, to cease payrolling benefits.

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Informally payrolling

If you do not register before the beginning of the tax year, an employer can write to HMRC requesting to informally payroll benefits for the year in question. It is important that an application is then made in good time before the start of the next tax year to formally payroll benefits, as this will not be assumed by HMRC. This approach has been said to be ceasing and HMRC have issued guidance to this effect, it is, at the time of writing, still possible to apply. However, it is considered only a matter of time before this approach is stopped.

What cannot be payrolled

With the exception of the two benefits detailed below, all benefits can be payrolled. The two exceptions are:

- Employer provided living accommodation
- Interest free and low interest (beneficial) loans

If either or both of these benefits are provided, they must be reported on a P11D; this is the case even where an employee is receiving other benefits which have been payrolled.

It should be noted that a car benefit can be payrolled and where this is the case, form P46 (Car) does not need to be submitted to HMRC.

How does it work each pay period?

Once the payrolling of benefits has been introduced, at the start of any given tax year, the value of the benefit for that pay period is included in the calculations for PAYE, with the tax being suffered (although the benefit amount is not paid to the employee). Any such benefit values are excluded for the purposes of Universal Credit calculations, although HMRC are reviewing this approach to try and ensure that the level of earnings taken into account fairly reflect the income and choices available to a household.

During the year, the actual value of the benefit may have to be estimated, as the value is not known in time for the payroll to be run – as soon as the value is known, an adjustment should be made to reflect the correct value and any underpayment apportioned over the remainder of the tax year (or in the following pay period if a small amount).

Year end process

On the basis that the application has been made to payroll benefits before the start of the tax year (and all benefits have payrolled), the only year end form required in relation to the reporting of benefits is the form P11D(b) to calculate, and then pay, the associated Class 1A National Insurance.

Alternatively, if the employer has applied to informally payroll benefits in any given tax year, a P11D(b) and P11Ds will need to be prepared, in the normal way, reporting the payrolled benefits. Once prepared, if on paper, the P11Ds should be marked “PAYROLLED” on each page, and then submitted to HMRC via the post. If the P11Ds are being submitted electronically, HMRC must be told in advance, using an online form. Electronic P11Ds can only be submitted if all benefits have been payrolled.

Whichever method is used, in line with all P11D(b) and, if relevant P11D, deadlines, the forms must be submitted by 6 July and the payment made electronically by 22 July in any given tax year.

Considerations prior to introducing payrolled benefits

Pros

For the employer, the introduction of such a scheme should reduce the compliance burden of preparing P11Ds at the end of the tax year and hence result in a time/cost saving. For the employee, the tax paid during the tax year should be equal to their tax liability and hence there is no time lag, with tax being owed retrospectively. In addition, once the system has been in place for a period of time, employee tax code queries, and wrong tax codes, should become significantly lower, freeing up management time.

Cons

For the employer, there is a need to ensure that the value of the benefit is correctly reported in each pay period. This necessitates close liaison with other personnel within the organisation to ensure the payroll processors are aware of any changes e.g. a change in the medical benefit part way through the year is communicated to payroll. Failure to report the correct values can lead to the employer incurring fines. It is recommended that a reconciliation is carried out prior to either the February or March payroll being run to ensure that the correct benefit has been processed. By leaving one or two months before the tax year end, this allows time to make any necessary adjustments.

For employees, this way of taxing benefits may accelerate their tax liability and in the first year, can lead to tax being payable on a benefit for both the prior and current tax year, leading to potential cash flow issues.

Other

Prior to embarking on this approach, the employer must:

- ensure that the payroll software has the functionality to correctly process benefits, such that tax is applied, but not National Insurance;
- tell the employees in writing of the change. This must be done clearly and include information on which benefits are to be payrolled, what it means to them in terms of their tax code, the year end payroll documentation they will receive and the effect on the reporting for their personal tax returns;
- be aware that they need to have a Government Gateway account to apply to payroll benefits – this can not solely be obtained by an external payroll provider.

In addition, at the end of the tax year, the employer must provide a summary of the benefits included in the payroll, although this is normally shown on the regular payslip, which is sufficient to meet this requirement. If a separate report is required, this must be provided to employees by 1 June following the end of the tax year.

Other factors

OpRA (Optional Remuneration Arrangements)

Benefits calculated under the OpRA rules can be payrolled, but care needs to be taken that the correct value is payrolled. This is the situation where an employee has an option to receive a benefit and forgo a cash alternative. If the value of the benefit, calculated under the benefits regime, is lower than the cash foregone, the higher value of the cash foregone must be used and processed as the benefit. The most common instance of this scenario relates to a car benefit, although it should be noted that electric cars have a specific exemption from this calculation.

The 50% rule

PAYE rules state that an employee can not suffer more than 50% tax compared with their taxable pay, in any given pay period, to ensure that the individual has sufficient money to cover their living costs. Where an employee's pay decreases significantly, generally in the circumstances of maternity leave, shared parental leave or an extended period of sickness, and their benefits continue to be provided, it may be that the tax can not be fully paid in each pay period. This is the main circumstance where the employer is permitted to stop payrolling a benefit for an employee part way through the year.

Employees leaving

Care needs to be taken when an employee leaves to ensure that the value of their benefits has been correctly reported and taxed in the payroll. The main areas which need to be considered are:

Car benefit – the benefit needs to be apportioned on a daily basis, rather than simply taking one twelfth of the amount, assuming a monthly payroll, to mirror how the benefit would be calculated if being reported on a P11D. This also applies to the fuel benefit, if provided.

Future benefits – upon leaving, some employees may be provided with benefits beyond their leave date. The full value of the untaxed benefits should be included in their pay calculations and where possible apportioned over the remaining pay periods e.g. a medical benefit is provided to an employee until the end of the tax year, but the employee leaves in January. If the leave date is agreed in November, the 5 months of the remaining benefit (November to March inclusive) should be apportioned over the remaining 3 months (November to January inclusive) when the employee is being paid.

In some circumstances there may be no further paydays to payroll the benefit. In this case, the employer has two options and whichever option is followed, HMRC will ask the employee for the unpaid tax. The options are to include the untaxed benefit on:

- the relevant pay period's Full Payment Submission and tell HMRC that the employee has left, if you have not already done so; or
- Form P11D.

Conclusions

There is no right or wrong answer as to whether an employer should payroll their benefits. If the payrolling of benefits is the route decided, it is important that the employer has systems in place to ensure that the correct value of benefits are being processed and that there is a good communication channel between payroll, HR and accounts (or whoever knows the value of the benefits being provided). As with many changes introduced, communication is key and employees must be aware of what is happening and the implications for them – after all, there are not many things that are more sensitive to an employee than their net pay!

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