bright graham murray
CHARTERED ACCOUNTANTS

KEY GUIDE

Making the most of fringe benefits

Why 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. 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.

The use of a flexible benefits package means that employees can select those benefits that suit them, and you might decide to use the services of a specialist provider. Benefits can be provided on top of normal salary, or they may be provided as part of a salary sacrifice arrangement. Employees will often be given a benefits budget to spend, and with a specialist provider, employees will usually be able to manage their benefits package online.

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

Tax treatment

Focus point

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

There is a distinction between P11D employees on the one hand, and lower-paid employees on the other – form P11D being used to report details of benefits to HM Revenue & Customs (HMRC) each tax year. However, the distinction is based on earnings of just £8,500 a year, so given the national minimum wage no adult full-time employee can be lower-paid. Directors will generally be classed as P11D employees regardless of earnings. The £8,500 distinction is to be removed from 6 April 2016.

Lower-paid employees normally do not suffer any tax if they simply have the use of an asset such as a company car.

P11D employees are generally taxed on what it costs to provide the benefit. So if medical insurance costs £1,250 a year per employee, then that is the figure that 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 for 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 PAYE. Although there is generally no employee NICs on fringe benefits, you, as the employer, will have to pay class 1A NICs 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

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 pension contributions or childcare vouchers.

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 of salary sacrifice using pension contributions

An employee 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 employee and employer are based on the full £30,000. Under a salary sacrifice arrangement, the employee could give up £2,000 of their salary, with the employer 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 where employee NICs are saved at the 12% rate.

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.

Focus point

An employee cannot use a salary sacrifice arrangement if it would reduce their cash earnings to below the national minimum wage rates.

The same principle applies with childcare vouchers, where an employee can be given tax-free vouchers to help with their childcare costs of up to £2,916 per parent each year. The childcare voucher scheme will not be available to new entrants from early 2017.

WARNING: The contractual arrangements must be watertight for a salary sacrifice scheme to work, so the employee should not be able to swap between salary entitlement and fringe benefits whenever they like. Also, the government is concerned about the increasing popularity of salary sacrifice arrangements and might therefore clamp down on their use at some future point.

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 dividing line between those benefits which are tax-free and those which are taxable.

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. However, 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. 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.

WARNING: Tax-free benefits are generally subject to strict conditions being met, and they will normally have to be available to your entire workforce for tax-free status to apply.

Motor cars

The company motor 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 also 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.

Focus point

Do not 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 car benefit covers all of all the costs associated with having a motor 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.

Example of company car choice

A director is provided with a brand new company Mercedes C – class Sport Auto costing in excess of £38,000, and a sales manager is provided with five-year old Ford Mondeo worth around £8,000. The director pays tax at 40% and does minimal business mileage, whilst the sales manager is a basic rate taxpayer and drives over 20,000 business miles annually. Rather surprisingly, the director's tax cost (despite paying double the tax rate) could well be less than that of the sales manager. This is on the basis that the director chooses the plug-in variant of the Mercedes C – class – despite this coming with a top speed of 155 mph and 0-60 acceleration in 5.9 seconds!

An employee can make a contribution of 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 pound more than normal variants.

For 2015/16, the percentage used is on the following scale:

- 5% where a car's CO_2 emissions do not exceed 50 g/km.
- 9% for emissions between 51 and 75 g/km.
- 13% for emissions between 76 and 94 g/km.
- A 14% 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%.

Unless you opt for a low-emission car, it may well be the case that taking additional remuneration or dividends and then buying or leasing a similar car personally is a more tax-efficient option. With the Mercedes C – class example again, the company car option makes sense if the plug-in hybrid variant is chosen, but may not be beneficial when it comes to a similar petrol or diesel powered variant. The decision can be quite a complicated one, with many factors and several taxes involved.

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 the car benefit, but based on a fixed value, which for 2015/16 is £22,100. Unlike other benefits where employee 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 up at work.

Focus point

Company car percentages are due to increase substantially over the coming years, with, for example, the 5% rate increasing to 7% next year, then to 9%, 13% and 16% by 2019/20 – a more than threefold increase.

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 HMRC's official rate, and the amount of interest actually paid. For 2015/16, the official rate is 3%.

Example of cheap loan benefit

On 6 April 2015 you make a £15,000 loan with an interest rate of 2% to an employee who wants to buy a car, with £5,000 being repaid by 5 April 2016. The average amount outstanding throughout 2015/16 is £12,500, so the taxable benefit is £125

(£12,500 x 1% (3% – 2%). The benefit for 2015/16 could have been avoided if the interest rate charged had been set at 3%, although in any case there will be no benefit for 2016/17 given the £10,000 limit.

Focus point

For 2015/16, forms P11D and P11D(b) will have to be submitted to HMRC by 6 July 2016. However, you have until 22 July 2016 to make the class 1A NIC payment provided this is done electronically.

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

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, with this exemption covering smart phones. 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 use, 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.

From 6 April 2016, there will be an exemption for trivial benefits that do not cost more than £50 per employee.

Reporting

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 expenses and benefits service which can deal with up to 250 employees. For 2015/16, P11Ds must be submitted to HMRC by 6 July 2016 with a copy given to the employee. In the unlikely event that you provide any taxable benefits to a lower-paid employee, then form P9D is currently used instead of form P11D.

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 2016 to make the Class 1A NIC payment provided this is done electronically.

On form P11D, you also have to report any expenses paid to yourself or to employees, and this applies whether or not the expense is for business purposes. However, where the expense is incurred for business purposes, a corresponding deduction can be claimed. It is currently possible to obtain a dispensation from HMRC so that routine business expenses do not need to be reported, and this will typically cover travel costs, telephone bills and entertainment.

From 6 April 2016, a new system will replace dispensations, with an automatic exemption applying from that date for deductible expenses.

The only in-year reporting that is required is in regard 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.

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.

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. When completing P11Ds, you would then show these benefits as being 'made good' so that a double tax charge does not arise. From 6 April 2016, payrolling is to be put on a more formal basis, and it will then no longer be necessary to include payrolled benefits on P11Ds.

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 round 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 PAYE settlement agreement (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.

WARNING: *If you want to payroll benefits for 2016/17, then you must be registered with HMRC by 5 April 2016 – it will not be possible to register after the start of the tax year.*

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.

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.

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