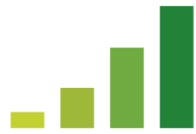

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Tax treatment of non-financial remuneration and costs associated with working

Stuart Adam, IFS

IFS residential conference, Cambridge, 5 September 2014

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Basic principles

- Things bought for the benefit of the employee should be taxed as (not deductible from) remuneration
  - Unfair to favour those receiving/paying in kind rather than cash
  - Inefficient to encourage payment in forms that may be less highly valued but are tax-privileged

- Things bought to generate income should be untaxed/deductible
  - Unfair and inefficient to encourage low-cost-low-revenue activities over equally valuable high-cost-high-revenue activities

➢ How do we separate these?

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Exactly the same issue arises for VAT

- Value added = wages + (cash-flow) profits
  - Measuring the 'wages' component is the same task as for direct taxes

In practical terms…

- Firms can deduct VAT paid on business inputs
- But wage payments are not a deductible input
- What if a firm buys something and provides it to the employee (or employee buys something, perhaps with the firm reimbursing)?
- ➢ Should be a VAT liability if item is for employee's benefit, but not if for purposes of the business (i.e. to generate revenue)
  - Exactly the same principle as for income tax and NICs
  - But the VAT treatment is determined in a totally different way
  - Should one of them be changed to look more like the other? Which?

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The current rules are different for…

- Income tax, employee NICs, employer NICs and VAT
- Items provided differently, e.g. employer provides *vs* contracts *vs* pays *vs* reimburses

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An example

Table 8.A: The tax treatment of gym provision for an employee

Employer A offers gym facilities to all employees on-site. Employer B offers gym membership to employees at the local gym with equivalent facilities. This costs £500. In each case the cost of the gym benefit is borne by the employer. The employees of A and B receive a benefit of approximately the same value, £500, although it could be said that the employees of A also benefit from the fact that the facilities are on-site. In each case it is assumed that the employee is a basic rate income taxpayer.

Which employer	Mechanics of payment	Employee Income tax	Employee NICs	Employer NICs	Method of reporting/accounting
A	Pays for the facilities on-site	None	None	None	None
B	Employer contracts with gym provider and pays provider	£100	none	Class 1A: £69	P11D Adjustment of tax code/self assessment
B	Employee contracts but the employer settles the bill directly	£100	£60	Class 1: £69	P11D
B	Employee contracts and pays and the employer reimburses	£100	£60	Class 1: £69	PAYE

Source: OTS review of benefits and expenses, second report

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The current rules are different for…

- Income tax, employee NICs, employer NICs, VAT and state benefits
- Items provided differently, e.g. employer provides *vs* contracts *vs* pays *vs* reimburses
- Employees and self-employed
- Different types of goods and services (cars, training, childcare, accommodation, travel and subsistence, business entertainment…)

➢ A difficult boundary to draw, but can anything justify drawing all these *different* boundaries?

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Back to principles

- Basic question: “Is the purchase generating consumption benefits or taxable income?”
- Not always obvious:
  - Does commuting generate earnings or save the cost of better-located housing?
  - Does a home office generate earnings or save the need to commute?
- What if the answer is “some of each”? E.g. a laptop:
  - Hard to monitor how much use is personal *vs* work-related
  - Even harder to estimate how much *value* is personal *vs* work-related
  - But even if we could do that, should we then…
  - …tax the consumption value (irrespective of business value)?
  - …deduct the business value (irrespective of consumption value)?
  - …tax the proportion of total value that is consumption value?

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What would the theoretical ideal look like?

I *think* (tentatively!) something like:

“Tax the amount the employee would have been willing to pay for the item if it generated no additional income; don’t tax (do deduct) anything in excess of that.”

Clearly not a principle that can be operationalised!

What practicable rule would get us closest?

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Why do apparently silly features remain in place?

- Lack of clarity as to the policy rationale?
- The best as the enemy of the good?
- Policy constrained by administrative mechanisms?
- Problems not significant enough to justify upheaval?
- Unwillingness to create losers?

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Conclusions

- A genuinely difficult boundary to draw
- But some parts of the current system just look daft
- And shouldn't we draw the difficult boundary in the same place throughout the tax system?

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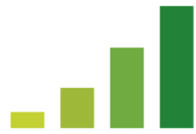

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