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

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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?
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?
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
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.

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

Source: OTS review of benefits and expenses, second report
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...)

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