Simplifying the PAYE Settlement Agreement (PSA) process
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) sets out below its response to the government's consultation on proposals to simplify the process employers' use for agreeing and reporting items to HM Revenue & Customs (HMRC) through a PAYE Settlement Agreement (PSA).

1.2 Employers can enter into a PSA with HMRC to make a single payment to cover the tax and NIC on certain benefits-in-kind and taxable expenses payments (BIKs). The scheme currently covers BIKs which are either minor or irregular, or are made in circumstances when it would be impracticable to apply PAYE.

1.3 The consultation document looks at how the PSA process can be made simpler and how guidance can be improved and follows from a recommendation by the Office of Tax Simplification (OTS).

1.4 The CIOT makes comments and recommendations to achieve a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities, in accordance with our objectives as an educational charity.

1.5 In responding to the PSA consultation the CIOT hopes to assist a balance being struck between employers' need for certainty when determining what can and cannot be included in a PSA and HMRC's need to reduce its costs in administering PSAs.

2 Executive summary

2.1 We welcome HMRC looking at this area following the OTS's recommendations. The OTS also recommended that that the scope of PSAs be widened so that employers can include any items they choose. We are disappointed that the government is not considering whether to widen the scope of PSAs, which we believe is an opportunity missed. In particular, PSAs provide employers with the flexibility to pay tax and NICs on items that would be

administratively difficult to process through PAYE or include on a P11D and there are items which fall outside the present criteria to which we refer below. We note that this aspect will be kept under review.

2.2 We agree that the government's proposed new PSA process, which removes the requirement to agree the items in a PSA with HMRC in advance of making the PSA return, represents a real simplification. However, a process will be required for employers to discuss with HMRC whether certain items can or cannot be included in a PSA where this is not clear from published guidance.

2.3 We agree that giving a warning to employers where an item has been included in a PSA in error, for whatever reason, rather than immediately penalising the employer would also be fair and proportionate.

2.4 We agree that a digital return option for submitting the PSA return should be introduced, subject to consultation as to how this process would work.

2.5 We do not, however, believe that the PSA return and payment deadlines should be aligned with that of the P11D process (ie a deadline of 6 July following the end of the tax year) as this would place too much of a burden on employers' staff resources in too short a time frame.

2.6 We do not agree with the proposal to remove 'minor' BIKs from the PSA criteria because of the new 'trivial' BIK exemption. As explained below there are items which are 'minor' which would not fall within the 'trivial' BIK exemption.

2.7 While it would be helpful for HMRC to provide in guidance some principles and examples as to how 'irregular' should be interpreted we do not agree, for the reasons set out below, with the proposal to exclude all contractual items from the scope of the 'irregular' category.

3 Proposed new PSA process – Response to the consultation questions

3.1 ***i. Do you agree that removing the requirement to agree the items in a PSA will provide simplification for employers? Please give your reasons.***

3.2 Yes, we agree that removing the need for employers to agree the items to be included in a PSA with HMRC in advance of the PSA being submitted (for a given tax year) is sensible and will simplify the process for employers.

3.3 Removing this requirement will save employers, and HMRC, time and effort. It will also remove the timing issue highlighted in the example on page 8 of the consultation document.

3.4 ***ii. Are there reasons why the formal agreement of a PSA should be retained? If so, what changes should the government consider to an agreement based system so that it is easier to administer?***

3.5 We do not believe that a formal agreement is needed – if employers report after the end of the tax year the items that have been subject to the PSA that should be sufficient.

3.6 That said, a formal agreement can provide reassurance for employers as to which items can and cannot be included in a PSA. Accordingly, the opportunity to have discussions with HMRC as to what can and cannot be included (particularly in any case of doubt) in a PSA will therefore be important.

3.7 If it is decided to retain a formal agreement process then an 'enduring' PSA would remove the requirement for an annual renewal process. If the PSA could then take effect from the start of the tax year in which the application is made (or, better, from the start of the previous year if the application is made before 6 July after the tax year end) there would be clarity.

3.8 We think that better guidance is needed to assist employers in establishing the appropriate rate of tax on items included in the PSA where there is a mix of basic/higher/additional/Scottish rate employees.

3.9 ***iii. Do you agree that having a digital PSA return would be simpler for employers to administer rather than the current PSA1 paper return? Please provide your reasons.***

3.10 We agree that there should be a digital option for filing the PSA return. We believe that a digital return would be preferable to a paper return for most employers.

3.11 A digital return is likely to be quicker to submit, should not get lost, and the format should be more easily reviewed and the contents checked by HMRC. In the long term it should also mean cost savings for employers and HMRC. However, a key element to a digital return process will be the ability to save a partially completed return while employers follow their review processes and collect further information that may then change what is included in the return. This is one of the deficiencies with the current PSA1 return which is an online form that cannot be saved but has to be printed after completion on-screen.

3.12 A paper return option should, however, be retained for those employers that are unable to file digitally (for whatever reason).

3.13 ***iv. A digital return would reduce error rates. Are there other changes the government should consider to reduce these further?***

3.14 Since much of the information to be included in the return cannot be automated (eg number of employees across each tax band) a digital return will not reduce manual input errors. In many cases the BIKs reported in a PSA arise from expense reporting systems and finance systems (eg staff parties) rather than payroll systems so extracting the relevant information is likely to remain a relatively manual process.

3.15 We do, however, agree that a digital return process should reduce computational errors as the calculations can be pre-programmed into the return.

3.16 ***v. Would aligning the PSA payment date with the Class 1A NICs payment deadline cause any employers particular hardship? Please provide your reasons.***

3.17 We agree with the government's view that PSAs should remain a yearly return. Introducing more frequent submissions, eg to align with PAYE reporting, would significantly increase the time and cost to employers of administering BIKs. As noted above, much of the information

required for a PSA item is not held within employers' payroll systems, so reporting under the real time information (RTI) process is likely to be impracticable.

3.18 In theory, removing the need to agree a PSA in advance could permit the alignment of the PSA return and tax and NIC liability payment date with the P11D/P11D(b) return and NIC liability payment dates (ie to 6 July and 19/22 July respectively).

3.19 However, a change in the filing deadline from 31 August to 6 July would present significant challenges for many employers. A shortened reporting deadline would bring forward the burden of completing the PSA return to a period when the employer is already very busy with other tax compliance obligations, such as Forms P11D and Form 42.

3.20 In particular, having employers rush to finalise the PSA return two months earlier than at present could lead to mistakes and misreporting in both the PSA return and on P11Ds. A large amount of work is put in by employers into collecting together all the information required for the PSA and, unfortunately, staff resources are not unlimited. Traditionally employers will focus on P11Ds in May-June and then turn to the PSA in July-August, once the P11Ds have gone in.

3.21 By way of example, if there are 1,000 employees there could be 2-3,000 items to find, coded as eg 'reward', 'recognition', 'drink', 'meal', 'event', 'thank you' etc. While most will be correctly posted others may be in the wrong place. It is this kind of checking and searching that large employers, in particular, have to do to ensure that they capture the right amounts for the PSA and this all takes time.

3.22 We would therefore recommend that any change to the filing deadline is at the very least deferred until payrolling of BIKs becomes commonplace (ie until there is a reduction in the end of year administrative burdens associated with P11D submissions).

3.23 ***vi. Do you agree that this approach would be proportionate?***

3.24 We agree that HMRC's approach of providing a warning to an employer if an item is included in the PSA in 'good faith' that HMRC believes should not have been included and only taking action if the employer continues to include the item, or similar items, in future returns is sensible.

3.25 We note that HMRC is proposing an exception to the above approach where the employer has not acted in 'good faith' or has not attempted to follow the rules.

3.26 Our concern would be in how one decides when an employer has not acted in 'good faith'. HMRC's view of a 'very clear statement or example' in guidance may not necessarily correlate with an employer's understanding of the guidance.

3.27 We would therefore recommend that HMRC adopt a pragmatic approach of warning first and taking action only if the error is repeated in <u>all</u> cases.

3.28 ***vii. Do you have any other comments about the proposed new PSA process?***

3.29 Please see our response to the previous question.

4 Defining what can be included in a PSA – Response to the consultation questions

4.1 ***Minor***

The government proposes to remove 'minor' from the PSA criteria and would like to hear employers' views on this.

4.2 ***viii. In light of the new trivial BIKs exemption, would the removal of 'minor' pose any problems for employers? Please provide reasons for your answer and examples of BIKS which this would cause difficulty for.***

4.3 We disagree with the government's proposal to remove 'minor' from the PSA criteria. Removal of this category will not be helpful to employers and it is difficult to understand the government's reasoning for narrowing the scope of PSAs, especially as the OTS recommended widening the scope.

4.4 We do not believe that the 'minor' category and the 'trivial' BIK exemption are interchangeable. For example, one of the conditions in the trivial BIKs exemption is that the benefit is not provided in recognition of 'particular' services. If it is then the BIK is taxable as it does not meet the requirements of the trivial BIK exemption.

4.5 There is an example of this difference between 'minor' and 'trivial' in HMRC's example on page 8 of the consultation document – the gift vouchers given to Amanda and Gerry would not meet the terms of the trivial BIK exemption. They are, however, 'minor' and it would seem right for employers to be able to include such items in a PSA. Were this not the case, Amanda in the example would have a £20 gift voucher but £6.40 less cash pay. This is not likely to incentivise her!

4.6 Another example would be non-executive directors' (NEDs) travel to board meetings. It is conventional for companies to reimburse these costs and meet the associated tax and NICs under a PSA as 'minor' items. To do otherwise would cause administrative hassle for the company and the NED.

4.7 ***ix. Are there items which you include in your current PSA which are 'minor' and which are not either 'irregular' or 'impracticable' as well?***

4.8 Yes, please refer to our response to the previous question.

4.9 In terms of the example in the consultation document, the vouchers provided to Amanda and Gerry are 'minor' but if, for example, the staff recognition scheme has an 'employee of the month' it is likely to fail the 'irregular' test. It would certainly fail the 'impracticable' test as well.

4.10 ***Irregular***

The government also proposes that irregular should:

- *be considered in the context of a tax year;*
- *should not be something which occurs in any pattern: every day, week, month, other month, or quarter; and*
- *not include items which employees have a contractual right to (for example bonuses, regardless of how infrequently or at what intervals they are paid or how they are made up).*

4.11 ***x. Do you agree that these principles should guide what can/cannot be included in a PSA as an 'irregular' item?***

4.12 We agree that there should be guidance to make it easier for employers to determine whether the provision of an item is 'irregular' or not and that, as now, an employer should consider the frequency an item is provided during the year when deciding whether the 'irregular' criteria has been met.

4.13 We are not, however, convinced that narrowing the scope of PSAs to exclude items which employees have a contractual right to is the right direction to take.

4.14 For example, removing all 'contractual' items from PSAs would potentially mean that items such as relocation costs[1], late night taxis and tax return preparation fees, eg for international assignees, would fall outside the scope of PSAs as usually the employer will have agreed contractually to pay for such items.

4.15 Another example might be the case of Amanda in the example in the consultation document. If she knows that if she hits a certain sales target she will be provided with, say, a £100 gift voucher that is a contractual BIK. If it is not included in the PSA, she will end up with less cash pay. If the employer attempts to rectify this having put it on a P11D form, eg by giving her a (taxed) 'bonus' at the time to meet the cost of the extra tax on the BIK the problem with matching tax payments with their funding (which may have occurred many months previous and not be remembered) happens.

4.16 Amanda's gift voucher might be regarded as 'minor' but if this category is removed (see Question viii.) then this would cause a real problem with no covering under a PSA being possible any more.

4.17 Furthermore, HMRC needs to be clear as to what it regards as 'regular'. For example, we think that it would be unfortunate if HMRC said that a business that held quarterly events to acknowledge the extra effort that goes into getting interim accounts out by the deadline for, say, Stock Exchange reporting was doing this regularly. Or a business that holds a regular end-of-month drink with the aim of bringing staff across the business together in an informal way is doing this regularly. It should not be overlooked how important it is for businesses to facilitate team building and staff collaboration.

4.18 ***xi. Are there any other principles which you think should be considered?***

4.19 Please refer to our response to the previous question.

4.20 ***xii. Do you have any other comments about how 'irregular' is interpreted?***

4.21 No.

4.22 ***Impracticable***

The government proposes that the provision of a BIK is not to be considered to meet the 'impracticable' test solely because of restrictions due to an employer's software or because there is presentational awkwardness to taxing the BIK via PAYE or reporting it on form P11D.

[1] See https://www.gov.uk/hmrc-internal-manuals/paye-settlement-agreements/psa1070 which says that '*relocation expenses where the amounts concerned exceed the £8000 tax exempt threshold (Section 287 ITEPA 2003)*' '*may constitute an irregular item*'.

4.23 ***xiii. Do you agree that these rules provide clarity? Would their application pose any difficulties for employers?***

4.24 We consider that there should be guidance to make it easier for employers to decide whether the 'impracticable' criteria has been satisfied.

4.25 We appreciate that the 'impracticable' test is aimed at impracticality in applying tax rules/tables and in apportioning the cost of shared BIKs between multiple employees and not solely because of difficulties with employer's systems or processes. Providing guidance to this effect therefore seems sensible.

4.26 ***xiv. Are there any other types of 'impracticability' which the government should consider?***

4.27 As at present it is simply important that all the facts are considered before a decision is made as to whether the 'impracticable' criteria is met. 'Impracticable' is a subjective criterion. What HMRC considers impracticable may not be the same as an employers' view.

4.28 For example, while the cost of food eaten by each employee from a buffet cannot be apportioned accurately to each person, it will have been bought from outside caterers on the basis of a 'per head' spend. So does that mean that HMRC thinks it is actually practicable to apportion the cost between employees on a rough and ready basis, albeit that each employee may consume more or less than another?

4.29 ***Office holders***

xv. Should the government consider an exemption/cap in respect of office holders? Please provide reasons for your answer.

4.30 No. The PSA process should be kept as simple as possible. There should be no cap or exclusion in respect of office holders. The trivial benefits cap for close companies is to prevent abuse of an exemption. The PSA is an alternative settlement method by which to account for tax and NIC.

4.31 ***xvi. What other safeguards could/should be considered to guard against possible abuse of PSAs?***

4.32 We appreciate that in the case of owner-managed businesses (OMBs) HMRC might be thinking about whether PSAs could conceivably be being used to avoid Class 1 primary NICs. However, we really cannot conceive that this could develop into a material avoidance area, particularly given that the marginal primary NIC rate is only 2% for the higher paid.

4.33 For large employers, with developed people policies, we do not see the PSA being used to avoid Class 1 primary NICs, rather it is used as the only way to ensure that an employer's motivational strategies achieve their purpose and that administration is minimal.

4.34 ***The scope of PSAs***

xvii. Are there any compelling reasons/scenarios which do not fit into the rules as set out above that employers feel the PSA process should be amended to include? Please provide reasons/examples.

4.35 Consider the staff recognition scheme referred to in the example on page 8 of the consultation document. If that scheme were a monthly award scheme and involved vouchers valued at £75 rather than £20 then it would potentially fail all of the 'minor', 'irregular' and 'impracticable' criteria. But we do not think it would be right for the voucher to have to be included in a P11D and for the employee to have to pay tax on it. It would defeat the object of the scheme in recognising the particular staff member for the extra effort that they had made for the business. The use of a PSA surely be the answer?

4.36 Another example would be office holders' travel, subsistence and accommodation expenses when travelling to a permanent workplace (eg board meetings). In particular, where the expenses are not 'minor'. Similar issues arise where employees are temporarily assigned to another workplace but the project goes beyond 2 years. The PSA is the most pragmatic way of accounting for tax and NIC on expenses of this nature.

4.37 It is essential to see the PSA in a wider context of how employers interact with their employees in the 21st century. In paragraph 2.2 of the consultation document the growth in the use of PSAs shows how employee reward and recognition has moved on from 1996 and increased employer awareness of how to deal with it. Indeed it may be that before PSAs many employers ignored these small items instead of agreeing a voluntary settlement. So we think this is a success and that HMRC should build on it by widening the scope for PSAs, not narrowing it.

4.38 We think that the requirement to state the number of employees at each tax rate for each item on the PSA1 could be simplified and, potentially, removed. For example, if an employee wins two 'Employee of the Month' awards do they count as 2 or 1? If he or she counts as only 1 for this purpose, there is a whole additional data requirement. For example, if there are 100 employees and two events attended by 50 people each were held, the employer has no idea if the same employees attended both or every employee attended only 1, or where the true overlap falls. To get the number of employees exactly right flies is difficult. We think it should be possible to use an estimate.

4.39 For many items where the relevant employees cannot be identified, the numbers at each tax rate is calculated by estimating from the payroll. As noted above, we think that this approach should be made explicitly acceptable. For example, who knows if the Finance Director popped in to a department's staff summer barbecue or not - and if they did, did they eat/drink or cost anything? So were there any 45% taxpayers to be included or not? A simplified approach is necessary to be able to estimate the numbers of employees at each tax rate in order to streamline the PSA process.

5 Acknowledgement of submission

5.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

6 The Chartered Institute of Taxation

6.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,600 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.