

Payroll changes for small businesses

HMRC has been running a consultation on payrolling, benefits in kind and taxable expenses payments since 2007, with the aim of putting an end to informal arrangements made between employers and their tax offices. It has just been announced that the consultation will be paused and the work on payrolling will be re-scheduled while HMRC re-analyses both the drivers for the work and how the impact on any potential changes on employers, employees and HMRC will be managed.

It's no secret that HMRC is struggling to find resources to cover the numerous consultations currently in progress but as far as payrolling is concerned, it could do worse than redirecting some of those resources at simplifying the process for reporting benefits and expenses generally.

The outcome of the work being carried out is likely to be new legislation which will either make payrolling compulsory for all employers (with an end to P11D returns as we know them), or a voluntary arrangement which would allow employers to choose whether to adopt payrolling or not. Whatever the outcome, payrolling will have a strict statutory footing and the current 'flexible' ad hoc arrangements will cease.

A third option would be to allow employers to payroll some benefits but not others, which would be similar to the informal arrangements already in place, since certain benefits lend themselves very easily to payroll while others do not. This option is unlikely to get the green light at the end of the consultation process because it has the potential to confuse employees if they switch jobs.

The difference between large and small employers

Payrolling has many benefits, as those with current informal arrangements will testify, but compulsory payrolling will increase the administrative burden for many businesses. For this reason, voluntary payrolling would be a preferable solution and, if the take up is good, it could lead the way for compulsory payrolling for employers over a certain size in future.

In many cases it tends to be larger employers that make informal arrangements with their local tax office because it offers them fewer tax code changes to deal with during the year, less queries from employees and as a result, less contact with HMRC, and less information gathering required for P11D returns at the end of the year. All of this can potentially represent a sizeable saving in terms of time and manpower where there is a large workforce involved.

It is larger employers who have been most favourably disposed towards the formalisation of payrolling, although it must be said that not all large employers are in favour. The picture is very different for small and micro employers, where there is often no dedicated payroll person, let alone a department.

Key areas of concern

The list below highlights some of the key questions and concerns that need to be addressed before payrolling can become a reality.

- Employees earning less than £8,500 per annum may have benefits that take them close to or over the limit for P11D reporting purposes. How does the employer decide whether or not to include them in payrolling at the start of the year? What happens if the employer gets it wrong?
- Balances on beneficial loans can fluctuate during the year. When to include them will be difficult to assess.
- Company car changes during the year are likely to present problematic and burdensome issues.
- The rules and regulations for Class 1A NICs reporting are not going to change. This can be a difficult area to assess on an annual basis but potentially dealing with it monthly is going to prove even more onerous.
- Medical and other similar annual benefits will need to be assessed and given a monthly value. Where changes are made during the year further assessments will need to be made and monthly values amended.
- Benefits that are spread but then cease during the year will create further amendments.
- Some benefits will be difficult to value until the year end, and some impossible to value until after the period end.
- Benefits that cannot be valued until after the year end will pose an even greater problem. This could possibly be resolved by using a month 13 routine or placing the benefits into the first month of the following tax year. However, this will cause further problems with differences in tax rates and the impact on self assessment taxpayers.
- Employees that need to file a self assessment tax return will want a summary of their taxable benefits, regardless of what has been payrolled.
- Expenses that are not covered by a dispensation will also need to be included, and this kind of information is often going to be very difficult to collect and calculate in good time, on a monthly basis.
- Ensuring that all benefits and expenses are collected and included for leavers will provide a further administrative challenge.
- Some benefits in certain circumstances could produce negative net pay. How will this be dealt with?
- It has been acknowledged by most involved in the consultation that some benefits just can't be payrolled so there will inevitably be some kind of adjustment exercise at the year end. Will this effectively amount to P11D returns as well as payrolling for some employers?
- What will be the impact of the new penalties regime in respect of errors under payrolling?
- How will agents deal with the monthly collection of data from multiple clients?

The list is by no means exhaustive and there are other areas of payrolling that will need to be addressed by the consultation e.g. the IR35 legislation, expatriates, and simplified deduction schemes to name a few, before payrolling can become a reality - voluntarily or otherwise.

For a lot of small employers, none of these problem areas will ever crop up in their payroll cycle, but even if this is the case, it still remains that under payrolling any queries that could previously be left for consideration once a year will now need to be addressed on a monthly (possibly weekly) basis. For agents and payroll bureaus that deal mainly with small businesses this problem will be escalated, in particular, in terms of continually educating clients and collecting data. This in fact is probably where the biggest administrative burden will lie if payrolling were to become compulsory.