Employment Income Policy Team
HM Revenue & Customs
Room 1E/08
100 Parliament Street
London
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For the attention of Mr Alexander Raisen

15 October 2016

Dear Sir

Consultation on salary sacrifice for the provision of benefits in kind

BCF Wessex is a multi-disciplinary consultancy and software development firm that specialises in company car tax and finance. We have longstanding experience of business car related tax and finance and advise many FN50 leasing companies as well as several motor manufacturers.

We have advised many clients on the development and implementation of salary sacrifice arrangements and would like to contribute to the consultation by providing responses to the questions raised by HMRC, insofar as they relate to the provision of company cars.

Introduction

Around 10 years ago, against a backdrop of increasing rates of income tax and NIC, the "tax gap" that originally launched the company car some forty years ago was restored. Taken together, the corporate discounts available to fleet operators and the increasing availability of low CO_2 emission cars enabled company cars to became a cost effective and tax efficient way of remunerating staff and employers were able to offer tax efficient company cars instead of salary as a means of recruiting, retaining and rewarding staff. With the popularity of salary sacrifice for cars growing some leasing companies, most notably Tusker and Fleet Hire, changed their focus to become salary sacrifice specialists; Tusker have become specialist providers to the public sector whilst Fleet Hire have pioneered a low cost salary sacrifice scheme aimed at small and medium enterprises.

Today, as well as Tusker and Fleet Hire, many leasing companies and brokers offer salary sacrifice for cars, including: ALD Automotive, Alphabet, Arval, Fleet Evolution, Hitachi Capital Vehicle Solutions, Inchcape Fleet Solutions, JCT600 Vehicle Leasing Solutions, Lex Autolease, LeasePlan, Maxxia, Ogilvie Fleet, Pendragon Vehicle Management, SG Fleet, TCH Leasing, Venson Automotive Solutions, and Zenith.

Before setting out our answers to the questions raised in HMRC's consultation document, we would like to outline some general points that we hope you will take in to account when considering whether the legislation proposed in the consultation document should be applied to company cars.

Salary sacrifice only works for low emission cars

Since the launch of salary sacrifice for cars, a series of ongoing legislative changes have effectively increased the taxation of company cars; for example, the appropriate percentage for a petrol car with CO_2 emissions of 120 g/km is currently 21% but as recently as 2012, before Qualifying Low Emission Cars (QUALECs) were abolished, the appropriate percentage for such a car was just 10%.

Given the basis of taxation of company cars, salary sacrifice for cars is effectively subject to a form of arbitrage, as income tax and NIC saved on salary sacrificed must be measured against the income tax due on the company car benefit.

As such salary sacrifice for cars only works for the lowest emission cars and cars that would have been suitable for salary sacrifice just a few years ago should no longer be offered to employees because they will not generate any savings for either the employee or employer.

Salary sacrifice cars have lower emissions than other cars

The BVRLA states that the average CO_2 emissions of salary sacrifice cars is 104 g/km[1], whilst the average emissions of Tusker's salary sacrifice cars are just 101 g/km[2], and nine of Tusker's top ten salary sacrifice cars have emissions of less than 100 g/km[3].

Last year the SMMT estimated that the average age of cars on UK roads was 7.8 years[4] with average emissions of 164 g/km[5] and, a recent BVRLA report[6] states that the average 'grey fleet' car in the UK is 8.2 years old and emits 154 g/km.

It is evident therefore that salary sacrifice supports the government's environmental objectives and treaty obligations by significantly reducing CO_2 emissions.

Application of employer savings

Contrary to popular opinion, in our experience most employers set up salary sacrifice car schemes to enhance the range of benefits available to employees rather than to generate bottom line savings.

Employers do not generally make any savings from salary sacrifice for cars because the Class 1 NIC saved on sacrificed salary is largely offset by Class 1A NIC due on the company car benefit, and the remaining savings are generally used to fund the set up and administration of the scheme and to offset the unforeseen costs that can arise when car leases have to be terminated early or when lease payments have to be maintained during periods of parental leave.

Employees taking up salary sacrifice are typically lower paid

Research[7] undertaken by the BVRLA indicates that salary sacrifice cars are predominantly taken up by basic rate taxpayers as a response to austerity which has had the effect of restricting wage increases, particularly in the public sector where salary sacrifice is most prevalent.

[1] http://www.bvrla.co.uk/news/press-release/benefit-kind-treatment-salary-sacrifice-schemes
[2] http://www.carandvanfunding.co.uk/sal-sac-specialists-tusker-react-hmrc-consultation-salary-sacrifice/
[3] https://www.contracthireandleasing.com/car-leasing-news/top-ten-salary-sacrifice-cars-revealed-by-tusker/
[4] http://www.smmt.co.uk/industry-topics/sustainability/vehicle-end-of-life/average-vehicle-age/
[5] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-New-Car-Co2-Report-2016-1.pdf
[6] http://www.bvrla.co.uk/sites/default/files/documents/bvrla_grey_fleet_final.pdf
[7] http://www.bvrla.co.uk/news/press-release/bvrla-responds-key-tax-policy-consultations

Aside from cost to the Exchequer, the other principal government reason to restrict the tax benefits available from salary sacrifice, is that it is unfair for some employees to be able to benefit whilst others cannot, with specific reference being made to those who are prevented from participating because of the application of National Minimum Wage restrictions.

Rather than seeking to level the playing field by withdrawing the benefits from all employees would it not be more equitable to devise an alternative solution that would enable all employees to benefit, by for example changing the NMW legislation to permit salary sacrifice via a government approved, low cost arrangement, similar to the low cost pension arrangements that have been devised to encourage saving for retirement?

Salary sacrifice cars generate revenue for the Exchequer

It has been shown that traditional salary sacrifice cars generate tax receipts[8] for the Exchequer, but take up of new generation schemes, such as Maxxia's recently introduced Lifestyle Lease, should increase those tax receipts because under that scheme none of the input VAT is recoverable.

Accordingly, the proposal to restrict the income tax and NIC advantages associated with salary sacrifice is likely to have an adverse impact on the total tax yield.

Salary sacrifice promotes new car sales

With 80%[9] of salary sacrifice cars being driven by basic rate employees, withdrawal of the tax benefits of salary sacrifice will have a significant impact on the net pay of the country's lowest paid employees many of whom would no longer be able to afford a new car on a regular basis.

Given more than 90%[10] of participating employees would not have acquired a new car were it not for salary sacrifice, curtailing the salary sacrifice car market would dramatically affect the UK automotive sector which now employs more than 800,000[11] people.

Salary sacrifice supports wider government objectives

Salary sacrifice for pension contributions is to be exempted from the proposed legislation, even though it is the form of salary sacrifice that generates the largest single cost to the Exchequer because it supports an important, wider government objective to encourage saving for retirement.

The same approach should be adopted for salary sacrifice for cars because they materially contribute to the government's treaty obligations to reduce greenhouse gas generation in the UK.

Question 2

What are the likely impacts on employers and employees of limiting the scope of BiKs that can obtain tax advantages when offered through salary sacrifice?

Impact on wage inflation

As noted above, evidence collated by the BVRLA and its members indicates that the majority of employees with a salary sacrifice car are basic rate taxpayers predominantly working in the public sector. These public servants have been encouraged to participate in salary sacrifice as a means of making their salaries go further during a prolonged period of austerity throughout which salary increases have been capped.

[8] http://www.fleetnews.co.uk/fleet-leasing/news/latest-fleet-leasing/2015/06/15/salary-sacrifice-boosts-tax-revenues-for-treasury
[9] http://www.fleetnews.co.uk/fleet-leasing/news/latest-fleet-leasing/2016/08/23/salary-sacrifice-caught-in-the-crossfire-of-hmrc-crackdown
[10] http://www.carandvanfunding.co.uk/sal-sac-specialists-tusker-react-hmrc-consultation-salary-sacrifice/
[11] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Sustainability-Report-FINAL.pdf

Accordingly, there is a risk that the withdrawal of the tax benefits of salary sacrifice would lead to increased demands for employees to be recompensed in the form of higher wages, which would fuel wage inflation and increased costs, especially within the public sector.

Impact on CO_2 emissions

According to the SMMT[12] the average car on UK roads in 2015 was manufactured in 2007, when average new car CO_2 emissions were 164 g/km. The average CO_2 emissions of new cars registered in 2015 was 121 g/km[13], but as noted above the BVRLA has stated that the average emissions of salary sacrifice cars are just 104 g/km[14].

Meanwhile in a report entitled *Getting to grips with grey fleet*[15], the BVRLA has estimated that the average age of a 'grey fleet' car in the UK is 8.2 years and that it emits 154 g/km. Grey fleet cars are among the least environmentally friendly on the roads, with barely any meeting Euro 6 emission standards and just 18% meeting Euro 5. Conversely, 28% of salary sacrifice cars meet Euro 6 and all meet Euro 5 standards.

With up to 100,000[16] salary sacrifice cars currently on the road salary sacrifice is contributing significantly to the government's objective of reducing greenhouse gases in the UK. Consequently, limiting the tax benefits of salary sacrifice is likely to have a detrimental effect on the government's environmental.

Impact on health and safety at work

As well as reducing the CO_2 emissions generated on business journeys, salary sacrifice cars are better maintained than the older, privately owned cars that would otherwise be used to undertake business journeys. Salary sacrifice cars therefore offer important health and safety benefits to employers that would be undermined should the proposed legislation be enacted.

Question 3

Are these impacts different, or are there different considerations, for large/small businesses or particular business sectors?

It's likely that the proposal would have more impact on smaller businesses for which increased wage demands might be impossible to meet, and smaller businesses are much less likely to be able to restructure their benefits arrangements to meet the conditions set out at clause 2.3 of the consultation document, thereby mitigating the effect of the proposal on their employees.

Given the high penetration of salary sacrifice within the public sector, should the proposal have a disproportionate impact on wages within that sector, that would ultimately increase the costs of the public sector possibly wiping out any tax savings generated by restricting the tax benefits of salary sacrifice.

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[12] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-New-Car-Co2-Report-2016-1.pdf
[13] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-New-Car-Co2-Report-2016-1.pdf
[14] http://www.bvrla.co.uk/news/press-release/benefit-kind-treatment-salary-sacrifice-schemes
[15] http://www.bvrla.co.uk/sites/default/files/documents/bvrla_grey_fleet_final.pdf
[16] http://www.bvrla.co.uk/EmployeeBenefits

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<u>Question 4</u>
Are the impacts different for particular BiKs?

For many of the benefits named within the consultation document the government's proposal will be relatively straightforward to implement; for example, with regard to mobile phones the proposal would merely dis-apply one statutory exemption designed to give tax relief for employees provided with a mobile phone by their employer.

In contrast, the proposal will be much more difficult to implement and administer for company cars, the taxation of which is governed by the specific, complex legislation set out at Chapter 6, Part 3, ITEPA 2003 (referred to hereafter as Chapter 6).

Over a prolonged period, Chapter 6 has promoted the uptake of low emission, environmentally friendly cars; between 2001 and 2015, it has encouraged manufacturers to reduce the average CO_2 emissions of cars from 177.6 g/km[17] to 121.4 g/km[18], and more recently it has powered the take up of ultra-low emission cars, two thirds of which are procured by fleets[19].

<u>Example 1</u>
Assume an employee has a headline remuneration package of £50k, with a salary of £45k and cash allowance, which may be taken in lieu of a company car, of £5k.

The employee is considering whether to select a VW Golf BlueMotion with a cash equivalent of £4,000 or a Nissan Leaf with a cash equivalent of £1,500.

Under the proposal the tax charge would be on £5,000 regardless of the car actually selected by the employee, meaning that any incentive within the benefits code designed to encourage the take up of ultra-low emission cars would become entirely redundant, as these incentives would be overridden by the 'greater of' rule set out in the consultation document.

<u>Question 5</u>
Do you think that the government needs to take any steps to mitigate the negative consequences of this change for employees and employers, such as those who may be locked in to salary sacrifice arrangements?

As cars are undoubtedly the largest cost items that can be procured via salary sacrifice, retrospectively applying a restriction on the tax benefits available to participating employees would have a substantial detrimental impact on take-home pay. Accordingly, if the government's proposals are enacted as set out in the consultation document, they should be grandfathered until the end of the underlying lease in order to protect employees who have agreed a long-term contractual change to their terms and conditions of employment in good faith.

<u>Question 6</u>
Do you consider that the approach proposed for legislation would work as intended?

With regard to cars the legislation would not work as intended because a simple anti avoidance measure, such as that proposed by the government, is incompatible with the complex, incentive driven company car legislation set out at Chapter 6.

[17] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-New-Car-CO2-Report-2012.pdf
[18] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-New-Car-Co2-Report-2016-1.pdf
[19] https://www.goultralow.com/press-centre/releases/uk-businesses-leading-way-electric-vehicle-revolution-says-uk-government/

The proposal would undermine the legislation set out at Chapter 6 with significant sections effectively being made redundant and it would seriously undermine the ongoing HM Treasury consultation on company car tax for ultra-low emission cars because incentives for the take up of low emission cars would be overridden.

If the proposal were also to apply to cash allowances, as stated at the round table event, potentially anomalous and unfair consequences might arise as set out below.

Example 2
In each of the following scenarios, the employee has a headline remuneration package of £50,000, with a salary of £45,000 and cash allowance, which may be taken in lieu of a company car, of £5,000.

The employee selects a VW Golf BlueMotion as a company car, for which the cash equivalent is £4,000.

Scenario 1 – Cash or car/No trade down option
Given the proposal is that benefits would be taxed on the greater of the cash allowance foregone or the cash equivalent of the company car we understand that the employee would be taxed on £5,000.

Scenario 2 – Trade down option
If the car only costs the employer £3,000 to lease, the employee is paid the remaining £2,000 as a cash allowance.

Given the complexity of the proposal set out in the consultation document, we are concerned that many employers would not be able to determine whether the employee should be taxed on:

i. *the £5,000 cash allowance (greater of cash alternative and cash equivalent) and the additional £2,000 cash actually paid;*
ii. *the £4,000 cash equivalent (greater of cash equivalent and cash allowance foregone) and the additional £2,000 cash actually paid; or*
iii. *the £5,000 cash alternative only (being greater than the cash equivalent)?*

Effectively, where there is no trade down option the proposed legislation would give a greater tax charge than currently levied but where there is a trade down option it is not possible to determine what the tax charge would be.

The resulting confusion would lead to mistakes being made by employers struggling to understand the new legislation and the consequent reporting requirements.

Question 7
Are there any consequences the government has not considered in proposing to legislate this way?

Potential impact on employment
The House of Commons Library Briefing Paper entitled *The motor industry: statistics and policy*[20] states that the UK motor manufacturing sector employs around 142,000 people and accounts for 8% of UK manufacturing output. As such motor manufacturing in the UK is highly significant, attracting substantial inward investment from overseas and providing a significant contribution to the balance of trade.

[20] http://researchbriefings.files.parliament.uk/documents/SN00611/SN00611.pdf

In its 2016 Sustainability Report[21], published just last week, the SMMT highlights that the total number of jobs supported by the UK automotive industry has risen to 814,000 and that the revenue generated by the sector have increased to £71.6 billion.

Potential impact on inward investment

Although the SMMT's Chief Executive, Mike Hawes has said that "The UK automotive industry can be proud of its achievements... delivering growth in volumes, turnover, employment and environmental impact" he has warned that the sector's continued growth in an increasingly competitive international market depends on a "supportive economic and regulatory environment".

To date the government has been supportive of the automotive sector, and commenting in the 2015 Sustainability Report Mr Hawes confirmed that the sector's targets for increasing productivity, innovation and exports aligned with the government's own priorities. However, given the SMMT's 2016 Sustainability Report highlights that one of the sectors major challenges is "maintaining and improving competitiveness to attract future investment …", the proposal to restrict the tax benefits associated with salary sacrifice appears to severely undermine the government's support of the automotive sector during a crucial time for the UK economy.

A report[22] prepared by PwC in 2015 stated that "Continuing to support the UK automotive sector continues to be important to the UK Government and the UK population, particularly those employed directly, indirectly and for all of us who benefit from the success of the sector. Salary sacrifice is one area where continuing demand for the output from the UK automotive sector can be supported, by enabling employees to continue the demand for new vehicles. This in turn will continue to support the manufacture of new vehicles and the 80% of components manufactured in the UK that go into them."

The UK electorate's vote to leave the European Union has already caused economic turmoil and the Japanese government's recent comments about investment in the UK have now been echoed by the Chief Executive of Nissan UK who has asked for government guarantees before committing to more investment at the company's Sunderland plant. As the Nissan Qashqai is one of the most popular salary sacrifice cars, enactment of the proposal set out in the consultation document will neither reassure Nissan, nor satisfy the other foreign motor companies manufacturing cars in the UK, many of whom acted on previous government policy supporting the manufacture of low emission cars in this country.

Increase of the grey fleet

Enactment of the proposed legislation is likely to lead to a significant reduction in the number of company cars in the UK which in turn will facilitate an increase in the number of higher emission, private cars used for business.

This will adversely affect employers' environmental obligations, give rise to important health and safety concerns as former company car drivers once again use grey fleet cars. It could also lead to an increase of up to 500,000[23] additional claims for Mileage Allowance Relief, which will be a direct cost for the Exchequer.

[21] http://www.smmt.co.uk/wp-content/uploads/sites/2/SMMT-Sustainability-Report-FINAL.pdf

[22] http://www.fleetnews.co.uk/fleet-leasing/news/latest-fleet-leasing/2015/06/15/salary-sacrifice-boosts-tax-revenues-for-treasury

[23] http://www.bvrla.co.uk/EmployeeBenefits

Question 8

Would the timeline present employers with difficulty, for example with updating payroll software?

Presuming the proposed legislation would apply from 6 April 2017 employers should have sufficient time to amend their P11D reporting procedures and train staff but this timetable is unlikely to afford sufficient time for those employers who have elected to payroll benefits to change their payroll systems. Given, voluntary payrolling of benefits is a recent measure encouraged by government to simplify the administration of benefits in kind implementing such a significant change at short notice is likely to discourage employers from participating in this potentially advantageous arrangement.

Question 9

Are there any other changes that employers would need to make?

We anticipate that many employers will have to engage extensively with trades unions and other staff representative bodies in prolonged negotiations and are likely to have to bear the cost of the proposals via increased salary costs.

Although salary sacrifice will not be banned, in practice the proposals are likely to reduce the advantages to such an extent that salary sacrifice will become unattractive to employees and unviable for employers. Meanwhile, some larger employers may choose to amend their flexible benefits schemes so that they meet the provision set out at clause 2.3 of the consultation document. Either course of action is likely to involve extensive negotiation with staff and their representatives and changes to employee communication, flexible benefits schemes, HR policies and procedures will result in significant additional costs.

Given the proposal applies equally to cash alternatives, as well as salary sacrifice, in the likely event that many company car drivers will ultimately opt out of their employer's company car scheme and then use their private car on business, employers will have to introduce robust procedures to ensure that grey fleet cars are properly maintained and insured, and comply with health and safety regulations.

Question 10

Are there any other compliance considerations which HMRC should be aware of?

Enactment of the proposed legislation is likely to lead to a significant reduction in the number of company cars in the UK which in turn will facilitate an increase of the grey fleet which could generate up to 500,000[24] additional claims for Mileage Allowance Relief per year.

Conclusion

We believe that company cars should be exempted from the proposal because salary sacrifice for cars has wider economic implications and supports the government objective of reducing the volume of greenhouse gases produced in the UK. We trust that our analysis of the importance of salary sacrifice cars to both the UK Exchequer and the UK automotive sector includes arguments, as well as evidence, that will persuade HMRC to add company cars to its 'white list' of benefits to be excluded from the legislation proposed in the consultation document issued on 10 August 2016.

[24] http://www.bvrla.co.uk/EmployeeBenefits

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If the government is minded to partially exempt company cars, as suggested during the round table event held on 15 September 2016, we would emphasise that the appropriate percentages derived via the application of Chapter 6 already deliver such a result. Cars with CO_2 emissions exceeding 100 g/km are no longer suitable for salary sacrifice, and impending increases to appropriate percentages will further reduce the emission threshold for salary sacrifice suitability, a partial exemption would be unwarranted.

Finally, if the arguments proposed by all interested parties and stakeholders have not persuaded the government to add company cars to its white list, given the majority of salary sacrifice cars are driven by basic rate taxpayers we would ask that you consider some potential alternative means of restricting the tax relief available, including:

- limiting the tax relief on salary sacrifice to the basic rate of tax only, with the 2011 changes affecting child care vouchers being a precedent; or
- applying an annual salary sacrifice allowance, with recent changes to the tax relief on pension contributions forming a precedent.

Should you have any questions regarding our response to your consultation or would like to discuss any of the points we have raised in more detail, please feel free to contact the undersigned.

Yours faithfully

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