

Taxing Flexible Benefit Packages

There used to be a time not that long ago when a Channel Islands employee's remuneration was equal to his salary – save for possibly a funded pension contribution. Understanding overall take home pay was straightforward, the only deduction often being Social Security. Benefits were not generally taxable at all and operating the payroll was not too onerous. Calculating the Social Security to be deducted and paid by the Employer was straight forward, particularly for employees paid above the social security threshold.

Changed Days

Times have changed. The tax systems have become more complicated and innovative forms of remuneration have evolved to attract the best staff in a tax efficient way. Typically a remuneration package will now include such benefits as critical illness insurance, death in service benefit, funded pension scheme, provision of accommodation, provision of company car, and items such as vouchers.

It is not uncommon for such benefits to be provided through a flexible benefits package, allowing each employee to tailor their employment package to their own circumstances. These packages offer benefits that can be chosen from a 'menu' and 'purchased' at a discounted rate through a reduction in take home pay. These schemes are often operated in the Channel Islands by large groups that operate such schemes in the UK where specific tax concessions exist to make such schemes attractive.

The UK System

In the UK, a flexible benefit package known as a salary sacrifice scheme often forms part of a remuneration package. The contract of employment is varied giving the employee the option to receive benefits rather than cash, such benefits being treated as "benefit in kind" for Tax and National Insurance Contributions ("NIC") purposes and not part of an Employee's remuneration. Such benefits are likely to be wholly or partly exempt from income tax and/or NIC thus reducing an employee's tax and NIC burden.

The Channel Islands System

The manner in which these benefits are taxed in Jersey and Guernsey is not the same as in the UK. The list of exempt benefits is much shorter and there is no equivalent to the relief under a salary sacrifice scheme. Defining remuneration when a salary sacrifice scheme is in operation therefore becomes complicated as certain benefits that would normally be excluded as exempt, become chargeable when provided in this way.

Payroll functions of many organisations are often centrally managed from the UK and the expectation within many of these departments is that the tax treatment in other jurisdictions, including the Channel Islands, will follow that of the UK. Unfortunately this is not the case.

Calculating remuneration for tax and social security

Any scheme that provides an option to receive cash rather than a benefit will be treated as part of remuneration, even where benefits that would otherwise be exempt are chosen. Where the scheme provides an array of benefits to choose from, the tax position in relation to each item needs to be considered separately along with the difference for Jersey and Guernsey tax purposes, and the differences in the treatment in Jersey between Income Tax and Social Security also needs to be addressed. Then there is the problem of valuing the benefit as alternative methods of calculation are available, that may be different in each case.

This issue is further complicated because the payrolls are often managed through bespoke computer software, written with the UK in mind, that is then amended for the rules in the Channel Islands. Such software was not written with so many variables in mind and the complications may have significant consequences.

Time for a checkup?

The obligation to deduct ITIS and Social Security correctly is the Employer's, but the liability is the employee's. Penalties can be levied where an employer gets it wrong and in extreme cases, criminal charges may be levied. The Income Tax and the Social Security Departments in both Islands have enforcement officers and in the current economic environment businesses are now more likely than ever to receive a compliance visit.

No one wants to receive a large, unexpected tax bill and with the increases in Social Security, it is more important than ever for employers and employees to ensure the correct amounts are deducted.

How can we help?

Employers need to review their systems and processes in respect of these benefit packages to ensure they are fully compliant for both Income Tax and Social Security/Social Insurance purposes. We at Baker Tilly have been involved in such projects for multinational financial institutions, ensuring compliance with the local laws and regulations and rectifying historical issues which have arisen. We don't just focus on the problems; we can also offer advice on ways to ensure tax efficient structuring of remuneration.

The increasing strain on the Islands resources has resulted in a changing attitude to enforcement. Don't think that you will not receive a compliance visit and don't underestimate the cost of getting it wrong. Even a small percentage of the total payroll cost spread over a number of years can quickly become a large amount, even before considering penalties. If you have problems,

voluntary disclosure is always cheaper than being found out and allows you to manage the problem rather than the regulator!

The potential impact

As an example, if a death in service benefit provided through a flexible benefit package, has been omitted from the IT IS and social security calculations, the consequences are not insubstantial. Take an example of an organisation with 200 employees and a benefit cost of £300 which hasn't be taxed correctly:

Potential exposure:

200 x £300 =	£60,000	Total cost of the benefit
Tax at 20%	£12,000	
Social Security 12.5%	£7,500	
Maximum under declared.	£19,500	
6 Year claw back	£117,000	

Plus penalties!!

This is only in relation to one potential benefit, not taking in to account more substantial elections such as cars or shopping vouchers. Added to this the administrative burden, and the communications required with disgruntled staff, it's important to handle with care and lean on someone with experience.

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