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Practical TAX Newsletter

The Reed Employment Case: Part 1

David Kirk asks: was there a salary sacrifice?

Readers may be surprised to learn that large banks are not the only organisations who have been indulging in 'casino capitalism'; the practice has also been deployed by one of our largest employment agencies: Reed Employment Plc. The curious feature of the Reed case is that the casino in which they have been punting is not the Stock Exchange, but the Tax Tribunal. In autumn 2011 they won £143 million in a VAT case. Just as well – they are going to need it if they are to suffer the loss of £158 million announced in January 2012 in a travel expenses case. These sums are not small change, even to them.

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Reed Employment Plc v HMRC (no. 4)

It is difficult to be sure quite what the implications of this judgment (UKFTT TC1727) are just yet, for it will certainly be appealed. Whilst some parts of the judgment look good, others I predict will certainly be overturned, and others still look rather bizarre and will need to be properly digested by the higher courts.

The case concerns a lengthy period in which Reed operated two travel expenses schemes for its temporary staff. Although one thinks of them as agency staff, Reed in fact set up contracts of employment for most of its temps. This started in 1995, and by 2004 applied to all temps, who Reed purported to enter into a salary sacrifice in order to get the travel-to-work allowances in place of taxed salary. Provided that the contracts of employment were 'over-arching' (meaning they covered all work done for Reed and continued between assignments) the workers' places of work would generally be temporary ones, and so travelling expenses between home and work would be allowable for tax. In order to give effect to this, HMRC issued a series of dispensations, the last of which was revoked in March 2006.

The issues that the tribunal addressed can be summed up as follows:

- Did the employees enter into a salary sacrifice arrangement, so as to get their travel expenses classed as benefits rather than pay? If not, then they could not be covered by a dispensation.
- Were the employment contracts over-arching? If not, then the employees' workplaces were permanent ones and so travel expenses would not be allowable for tax in any event (dispensation or no dispensation).
- What does a dispensation actually do?

The judgment covers all these separate but interrelated questions over 65 pages, identifying nine issues. This article covers the first two issues addressing the effectiveness of the

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salary sacrifice. Part two of this article will address what constitutes an over-arching contract of employment, together with the judges' observations on dispensations.

1: Did the employees enter into an effective salary sacrifice?

The importance of this is that if they did, it was *possible* (this was issue no. 2) that the travelling expenses allowances could be catered for in the dispensation.

The Tribunal's view was that they did not, so the judgment on the other issues is not strictly speaking part of the decision. This is an unusual question to have to decide, as normally one sacrifices salary in exchange for a benefit (such as a car, or private health insurance). In this case they were supposed to be exchanging cash under one label for cash under a different label: what actually matters is what the cash is *for*.

Under ITEPA 2003, s 62 'earnings' means 'any salary, wages or fee; any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is in money or money's worth; anything else that constitutes an emolument of the employment'. The reference to 'money's worth' is important: this is defined as something that is 'capable of being converted into money or something of direct monetary value to the employee' (such as: a company car into £5,000 extra pay). However, if it is not capable of being converted into money, the car is a benefit, and so is taxed according to the rules that pertain to benefits. (Curiously, this rule has no equivalent in National Insurance – there the car is taxed as a benefit even if it can be converted into money.) That is why, to be an effective salary sacrifice, a contract may not stipulate that the benefit may be converted into cash.

ITEPA 2003, s 62 does not apply to sums 'paid to the employee in respect of expenses', which are covered by ITEPA 2003, s 70. These are 'treated as earnings', which means that the tax ultimately payable on them is just the same (legitimate expenses can be offset against either); However, the mechanics are different as a dispensation can cover s. 70 money but not s. 62 money, and it was the dispensation that Reed was after. Expenses payments are the only chapter in the benefits code that taxes cash payments, which is why it is easy to confuse the issue.

The judges maintained in this case that the sacrifice was ineffective for the following two reasons:

The presentation

Here a temp on £10 an hour who had worked 40 hours would receive a payslip saying that he had received:

(a) £400 in salary; and
(b) a deduction for travelling expenses (say £25);, and
(c) the £25 would be added back again as an allowance (in one of the schemes it might be a slightly different amount).

The taxable amount was thus £375, or (a) minus (b). However, the fact that the payslip said £400, together with the opaque way in which it was explained (or not explained) in the contract, meant that the temps did not have any concept of having made a salary sacrifice and Reed did not appear on the face of it to be operating one;

Their argument appears to be circular

Ability to opt in and out

Under one of the schemes the temps could opt in and out of it at will. On the principles mentioned above this meant that there was no salary sacrifice.

The judges do make the point that: 'In our view a salary sacrifice implies reciprocity: the employee gives up a portion of his or her earnings, even if the portion is variable, in exchange for an identified benefit provided by the employer. Reed, however, did not provide any benefit at all; it merely applied the dispensation in order to enable it to attribute part of the pay, entirely notionally, to the reimbursement of expenses.' Being pedantic, this looks correct, but the question is what relevance it has. In order to examine this we need to look at issue no. 2.

2: Were the disputed allowances within s 62 or s 70?

What the judges were asking themselves here is whether, if a salary sacrifice had been made, the temps were giving up s 62 cash for s 70 cash, or simply for a different lot of s 62 cash. On this issue they came down on Reed's side – that is to say, the temps were receiving allowances that were 'paid to the employee in respect of expenses' and so falling within ITEPA 2003s 70. However, their reasoning is not totally clear: it seems to presuppose that the places of work were temporary, which they say further down that they are not. Their argument appears to be circular.

Conclusions so far

- To be effective, a salary sacrifice must be something understood as such by the employee (or it should be reasonable to assume that the employee has understood it as such).
- The employee must not be able to exchange the benefit for cash. In the case of an expenses payment, this means that the employee must not be able to claim the money as salary: it has to be identified as expenses.
- Payments identified as being in respect of expenses are taxed under the benefits code and thus eligible for a dispensation (other conditions being fulfilled).

The remaining issues from this case will be discussed in part 2 to appear in TPT August (2) 2012. **TPT**

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