EMPLOYEES' TRAVELLING EXPENSES

This Memorandum deals in general terms with the complex rules relating to employees' travelling expenses and subsistence costs. It is important for all employers whose employees travel as part of their duties to have an understanding of these provisions. Failure to take account of the rules could prove very costly, not only in terms of the resulting arrears of tax, but also in interest and penalties, if errors are found by the Inland Revenue.

THE ISSUE

It has been recognised for some time that the tax treatment of employees' travelling expenses has been unsatisfactory and full of anomalies. Unfortunately, the new rules which applied for the first time during 1998/1999, although containing fewer inconsistencies, remain complex. One of their more onerous consequences is that employers must maintain relevant records in greater detail than before.

Travelling expenses have always been a popular and fruitful area for investigation by Inland Revenue PAYE auditors because of the wide scope for error by employers. This has not changed. Although the sums involved may be relatively small, the settlements arising from even apparently minor errors can be quite substantial because:-

- PAYE and NICs 'lost' will generally be recovered by the tax authorities from the employer - not the employee

- the Inland Revenue can recover tax (and interest) for the preceding 6 tax years, as well as for the current year

- if records are inadequate, the Inland Revenue will review the position of a small number of employees and seek to charge tax on an extrapolated basis across the entire workforce

- the Inland Revenue can impose a penalty of up to £3,000 for each incorrect P11D in addition to a tax-geared penalty for failure to deduct the correct income tax and NICs.

As a result, the financial impact of errors can be disproportionately large on a small business.

THE BASIC RULE

The Inland Revenue's underlying position is unchanged. Relief is not available for expenses incurred involving a journey between the employee's home and his or her permanent workplace even if a business visit is made en route. This is now termed '*ordinary commuting'* and only the extra costs incurred are not taxable.

Even if it can be shown that the journey was not *'ordinary commuting'*, it will only qualify as business travel if the employee's duties require him or her to undertake such travel as part of the employment.

However, travelling expenses are incurred in a wide variety of situations and the application of this basic rule has in the past given rise to considerable practical problems. Recent legislation has attempted to address these and in particular:

- tax relief is now available on all business travel, irrespective of whether the journey begins from home or from the place of work

- a person who is assigned, in succession, to a number of different locations is now eligible for tax relief so long as he or she is not actually located at a specific site for more than 24 months and there was no intention at the outset that this period would be exceeded

- to qualify for relief a journey does not have to be made by the shortest route if another is more appropriate.

There are anti-avoidance provisions to prevent the employee from converting what is essentially a commuting journey into business travel, but the Revenue will not invoke these rules if small sums and short distances are involved, or if the visit involves extra travel of at least 10 miles each way. The terms *'small sum'* and *'short distances'* have not yet been defined by the Revenue.

SOME COMMON PROBLEM AREAS

The Inland Revenue booklet on the treatment of travelling expenses is extremely long and detailed and this Memorandum can only highlight some of the more common areas where problems may occur.

Site-based Employees

Employees who regularly move from site to site and who do not have a permanent workplace are not covered by the normal business travel provisions but will generally qualify for relief for travel between home and each site.

However, there is an overriding rule which may pose problems, especially in relation to the building industry where many labour-only sub-contractors have now been reclassified as employees. A site will be regarded as the **permanent** workplace of the employee if the employee is likely to work there for all (or almost all) of the period of the employment. In addition, of course, the 24 month rule described above also applies to site-based employees.

Employees who work at home

To qualify for relief for the expenses of business travel from home it must be *'an objective requirement of an employee's duties'* that *'substantive duties'* are carried out at the home address. Such relief is not available where working from home is a matter of convenience and not an objective requirement.

Employees whose duties are defined by reference to a geographical area

Where an employee, typically a salesman or service engineer, has a job which defines his or her duties by reference to a particular geographical area, the area is treated as the permanent workplace and all expenses of travel within that area and to other work places outside that area are tax-deductible for the employee. There are three criteria which must **all** be satisfied for this treatment to apply:

- the employee has no single site which is a permanent workplace, and
- the employee attends the area regularly, and most importantly
- the employee's duties are defined by reference to a geographical area.

Where an employee lives outside the working area, the costs of travelling to the area are not allowable.

COMPANY CARS

Until 5 April 2002 it was necessary for employees with company cars to maintain records of business mileage in order to determine the relevant level of "scale" benefit. The scale is no longer related to business mileage, so these records are no longer required for tax purposes, although business mileage still needs to be recorded.

An employee who provides his (or her) own transport for business purposes can now take advantage of the "mileage allowance scheme". From 6 April 2002, the employer can pay an allowance up to the amounts shown below, and the payments will not be reportable to the Inland Revenue, and will be free of Income Tax and NIC's:

Cars & Vans	On the first 10,000 miles in the tax year	40p per mile
	On each additional mile	25p per mile
Other	Motor Cycles	24p per mile
	Bicycles	20p per mile

For cars and vans, a further allowance up to 5p per mile can be paid for each passenger making the same business trip.

If the employee is paid less than the relevant mileage allowance, he (or she) can claim tax relief on the difference between the rate and the amount received from the employer.

Conversely, if the employer pays an amount higher than the laid-down maximum, the excess will be reportable and liable to both Income Tax and NIC's.

From 6 April 2002, it is no longer possible for an employee to claim expenses for business use of his (or her) own vehicle. If this was in fact happening up to 5 April 2002 then, for capital allowances purposes, the vehicle will be deemed to have been sold at 5 April 2002 at market value usually giving rise to a balancing allowance at that date. If – exceptionally – the market value exceeds the written-down value, the Revenue will permit the employee to treat the written-down value as market value, thus avoiding a balancing charge.

EMPLOYERS' RESPONSIBILITIES

As the penalties for error are levied upon the employer, it is more important than ever that adequate records are maintained to support employees' claims for allowable costs of travelling. These should include:

- a clear description of each employee's duties including a definition of his or her permanent workplace

- establishment of systems which manage and control the authorisation, recording and payment of expense claims

- where employees use a private vehicle for business purposes, well documented records of business mileage to support mileage allowance claims should be kept and presented to the employer.

Remember that **the employer** must certify that P11D particulars are "fully and truly stated".

All such records should be updated as regularly as necessary to take account of, for example, changes in employees' roles and new rates of reimbursement.

Particular care is necessary in cases where an employee of one company in a group receives reimbursement from other companies in the group. These can be easily overlooked, but they must be properly recorded and reported where appropriate.

DISPENSATIONS

Subject to agreement with the Inland Revenue, it may not be necessary for expenses to be reported and for the employee to claim relief. However, Revenue agreement is no longer needed in cases involving mileage allowance payments (see above).

In other cases, the Revenue must be satisfied in advance that no benefit arises and that the expenditure is properly recorded and controlled by the employer. Note:

- If the employer has a dispensation under the old rules (pre 1998-99) and decides to change the reimbursement arrangements in the light of the new rules, application should be made for a new dispensation.

- It may be possible to obtain a dispensation under the new rules which would not have been available under the old rules, e.g. for the reimbursement of journeys from home to a temporary workplace.

Obtaining dispensations for certain travelling and subsistence expenses will relieve the employer of the burden of reporting these but will not change the need to keep adequate records.

If you have any doubts about your compliance with the new rules we will be happy to advise further. Your next PAYE audit could be only a few months away!