Tax on National Insurance explained

Rewarding individuals for their commitment is an excellent way to boost satisfaction and productivity in the workplace. However, such rewards will attract income tax and National Insurance Contributions (NICs). This leaflet sets out the different tax liabilities incurred when vouchers are used as rewards and incentives, and explains who has to pay what in some common circumstances.

The taxable value of a voucher

The taxable value of a voucher depends on whether it is a cash or a non-cash voucher.

Cash Vouchers

A cash voucher is one that can be exchanged for a sum of money greater than, equal to or not substantially less than the cost of providing the voucher.

Cash vouchers are taxed in full in the same way as regular pay. Income tax and employee NICs are due on the face value of the voucher, regardless of the cost to the employer, and must be accounted for through the PAYE system along with employer NICs.

The employer provides an employee with a voucher that costs £40 to buy, but which can be redeemed for £50 cash.

As this is a cash voucher, the amount chargeable to tax and liable for NICs is £50. This should be accounted for through the PAYE system, rather than a PAYE Settlement Agreement ('PSA') or Taxed Award Scheme ('TAS').

Non-Cash Vouchers

A non-cash voucher is one that is capable of being exchanged for goods or services, and the cash value of which is substantially less than its cost. Non-cash vouchers are treated as benefits in kind, so income tax and NICs are due on the taxable value of the vouchers given to any director or employee. With effect from 6 April 2016 there is no longer a different treatment for employees earning less than £8,500 pa.

The taxable value is the cost of the provision of the voucher. Therefore, where the employer purchases the voucher at a discount, only the discounted value is subject to income tax and NICs.

The cost of the vouchers should be reported on the employees Form P11D for tax purposes. For National Insurance purposes the cost of the vouchers should be added to the employee's earnings for Class 1 National Insurance purposes.

An employer gives a voucher to an employee. It can be exchanged for goods at a local retail store. The face value of the voucher is £100, but the employer negotiated a discount and purchased it for £95.

As this is a non-cash voucher, the amount chargeable to tax and liable for NICs is £95 (tax is collected via P11Ds and NICs via payroll). Alternatively the employer can elect to pay the tax/NIC on behalf of their employees/third party employees by entering into a PSA or TAS with HMRC

Rewarding your own employees with vouchers

As with all benefits, the employer is obliged to account for tax and NICs on the payroll, and record the benefits given to each employee on separate P11D forms, unless they enter into a PSA with HMRC.

However, reporting benefits such as non-cash vouchers on a P11D still leaves the recipient of the benefit liable for income tax and employee NICs. Therefore when HMRC recover this tax via an adjustment to the employee's tax coding or self assessment, it can diminish any motivational effect. For this reason, it is often better for employee motivation to deliver employee benefits free of all tax and NICs to the recipient by arranging a PAYE Settlement Agreement (PSA) with HMRC.

PAYE Settlement Agreement

This is an annual agreement negotiated between the employer and HMRC under which the employer pays all due tax and NICs in relation to certain benefits provided to employees. The payment of the tax liability on behalf of the employee is a taxable benefit in its own right and therefore all tax paid via a PSA must be grossed-up at the correct marginal rate of tax.

The employer is responsible for keeping a record of taxable benefits provided to employees. This record should note the benefits as well as the sums spent, but does not need to detail which benefits go to which employee as would a P11D.

A PSA must be agreed with HMRC before 6 July following the end of the tax year (i.e. 6 July 2018 for tax year 2017/2018). However, it is important that a PSA is in place prior to providing non-cash vouchers to employees to ensure that no employee NICs are due.

Under a PSA, employee NICs are not due. However, it is up to the employer to ensure that the remaining tax and employer NICs are paid at the appropriate rate, accounting for the correct grossing-up of the tax cost. Furthermore, all costs due under a PSA are payable by 22 October after the end of the tax year (19 October if paying by post) to which the PSA applies.

With a voucher bonus awarded in April, NICs would be deducted in April and paid to HMRC in May, via Real Time Information ('RTI'). Under a PSA, this payment would not be due until October of the following year – 18 months later.

With regards to other employee benefits, it should be noted that it will not always be possible to report on the company's PSA, as a PSA only applies to benefits that are minor, irregular or impracticable to determine the benefit appropriate to each employee. Accordingly, employers can not include high value benefits like company cars, or cash payments such as bonuses.

Rewarding third parties

When rewarding third parties, such as sales staff at an external agency, it is not possible to report or account for the taxes due on benefits through payroll or a PSA, so a TAS must be set up to account for any tax.

Similar to a PSA, a TAS is a fixed-term arrangement made with the HMRC Incentive Award Unit that enables the award giver to pay some or all of the recipient's tax liability on awards provided.

When rewarding third parties under a TAS, the award giver usually accounts for the recipient's basic rate tax and employer NICs and records these on a tax return. No employee NICs are due on awards to third parties made under a TAS. The award-giver needs to give recipients a certificate showing the gross amount of award and tax paid for that year. If the recipient is liable for further tax, e.g. he or she is in a higher/additional rate tax bracket, it is their responsibility to inform HMRC.

Third parties rewarding your employees

If a third party arranges to reward your employees with non-cash vouchers under a TAS, they may choose to account for the recipient's income tax and must account for employer NICs (Class 1A). Employee NICs are not due.

If you arrange for or facilitate a third party to reward your employees under a TAS, you will be liable to account for employer NICs although the provider remains responsible for accounting for the tax liability.

Key facts

- **TAS returns must be submitted by the provider by 6 July following the end of the relevant tax year**
- **PSAs must be agreed with HMRC for each tax year that benefits are provided by 6 July following the end of the tax year. Where gift vouchers are provided, the PSA must be agreed with HMRC prior to the award of any vouchers to employees.**
- **The employer is responsible for completing the PSA calculation and submitting to HMRC, typically by 31 August following the end of the tax year.**
- **Tax and NICs are payable to HMRC by 22 October following the end of the tax year (19 October if paying by post).**
- **When a PSA is used to reward employees, or a TAS is used to reward third parties, delivering benefits is more advantageous and beneficial to the employee because the employer pays the tax/NIC on the employee's behalf.**
- **Setting up a PSA or TAS simplifies administration of taxes on benefits.**
- **Under a PSA or TAS a return detailing benefits awarded does not need to be submitted until after the end of the tax year, improving cash-flow.**

Did you know

- **Long service awards and payments of up to £5,000 for a good suggestion from an employee can be tax free!***

*Subject to certain criteria being satisfied. For details, contact your local tax office.