

Analysis

What's allowed for car allowances?

Speed read

The payment of car allowances and mileage allowance payments can have significant financial implications for employers and employees. Employers must ensure they fully understand how income tax and NICs legislation applies to the payments they make, ensuring they can access the income tax and NICs relief available. The recent Upper Tribunal decision in *Laing O'Rourke Services Ltd & Wilmott Dixon Holdings Ltd*, which HMRC has decided not to appeal, will make obtaining relief easier and should ensure NICs are not paid unnecessarily on payments made to an employee to use their private car for business purposes.



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Car allowances are usually offered as an alternative to providing a company car, giving flexibility of choice for employees and the promise of simplified administration for employers. Recent HR and benefits benchmarking surveys suggest that most companies offer a car allowance in some form. On the face of it, providing a car allowance appears to be relatively simple. However, when you look at what is required to operate a fair, compliant and straightforward policy, the picture is not so clear. In this article, we look at the income tax and NICs treatment, and the impact of a recent Upper Tribunal decision which may help reduce costs associated with employees driving for business.

Note that this article concerns employees using their private car for business journeys. There are separate rules for motoring expenses for company cars. Care should be taken not to confuse the two regimes.

What are car allowances?

It is important to first explain what is meant by 'car allowances'. Here, we mean a round sum allowance provided by an employer, which is usually a fixed amount paid through payroll and intended to fund a private car to be made available for business use (referred to as a 'car allowance'). A car allowance is subject to income tax as earnings (under ITEPA 2003 s 62) and primary and secondary class 1 NICs as earnings (under SSCBA 1992 s 3). As such, a car allowance must be included in apprenticeship levy calculations. Note

that a car allowance does not count as pay for national minimum wage purposes.

When taking a holistic view, it is important to consider the allowances paid to employees undertaking business mileage (referred to as mileage allowance payments or MAPs). These payments are usually intended to reimburse employees for costs incurred when they use their own car for business purposes. ITEPA 2003 ss 229–236 provide that MAPs and approved mileage allowance payments (AMAPs) are exempt from income tax up to a certain level.

There are different rules to consider for the NICs treatment of MAPs. As HMRC point out (in their *Employment Income Manual* at EIM31205), 'while the tax and NICs schemes were aligned as much as possible, they differ in various ways. You should not assume that something that is true for one scheme is also true for the other'. The NICs treatment for MAPs is set out in the Social Security (Contributions) Regulations, SI 2001/1004, reg 22A. This legislation introduces the concept of relevant motoring expenditure (RME), which includes MAPs and allows them to be disregarded from earnings for NICs purposes up to a qualifying amount (QA). The result is similar to the position for income tax, but the calculation mechanism is different.

Providing car allowances: key points

An employer providing a car allowance must decide how they wish to set the values of the car allowance and MAPs they will pay. Often, a car allowance will be set at a level to cover some, or all, of costs associated with acquiring a private car so it is available for business journeys. To do this, an employer must implement a methodology to identify the costs which are to be considered and how they should be valued. Employers should consider issues including how to value the cost of financing a private car, whether the allowance should cover other motoring costs, and if different employee populations need different allowances. Often, employers also consider the competition, benchmarking the level of car allowances against the market to compete for talent. The importance of setting policies with a strong environmental focus and an incentive to reduce vehicle emissions is increasing.

Employers face similar challenges setting their policy on MAPs. ITEPA 2003 s 230 sets out the AMAP rates that are exempt from income tax: currently 45p per mile for the first 10,000 business miles in a tax year and then 25p per mile thereafter. However, this differs for NICs. Regulation 22A(4) provides that only the higher AMAP rate of 45p per mile is considered for NICs. These rates were set over a decade ago and since then the CPI has increased by 40.8%. There may be an argument that the rates set out in legislation should have risen in that time to account for inflation. This was debated by members of Parliament in July 2023, but no increase was agreed.

Despite the pressure on motoring costs, common practice is for employers to set MAP rates below the maximums set out in legislation. Often, for simplicity, the rates used are aligned to the advisory rates published by HMRC for company cars, which are intended to cover the cost of fuel only. The legislation describes MAPs as amounts 'paid to an employee for expenses related to the employee's use of such a vehicle for business travel'. In a private car, the expenses of business travel will be more than just fuel because additional mileage for business may increase the cost of finance, depreciation, servicing, tyres, repairs and motor insurance. However, it is difficult to quantify these additional costs. Usually, the reason for setting MAP rates below the full approved rates is that employees have already been paid a car allowance to fund some of these costs. Therefore, paying the full approved

rates effectively funds some costs twice unnecessarily, even if approved in legislation.

Where an employer decides to set its MAP rates below those set out in legislation this triggers another disconnect between income tax and NICs legislation. ITEPA 2003 s 231 and s 232 detail how an employee is entitled to mileage allowance relief (MAR) if the total value of the MAPs they receive in any tax year is below the approved amounts. This allows employees to get income tax relief where they do business mileage, increasing the level of funding received, but only to the extent they do business mileage. For example, if an employee travels 6,500 business miles in the same vehicle in a tax year, and is paid 15p per mile as a MAP, they would be entitled to £1,500 of MAR:

- **Step 1:** Calculate the value of the approved (exempt) amount: 5,000 miles x 45p as the approved amount = £2,250
- **Step 2:** Deduct the value of the MAPs already received: 5,000 miles x 15p as the MAPs received = £750
- **Step 3:** If the answer is positive, the employee has received less than the approved amount and should be entitled to MAR on the difference: £2,250 - £750 = £1,500

The value of MAR for the employee will depend on their marginal tax rate, £1,500 of MAR being worth £300, £600 and £675 p/a for a basic rate, higher rate and additional rate taxpayer, respectively.

The issue of relief is where a significant disconnect between income tax and NICs legislation occurs, as there is no equivalent to MAR in the NICs legislation. There is an argument that employees miss out on NICs relief for expenses incurred on business journeys. This seems at odds with a general principle that employees should be entitled to an exemption or relief from income tax and NICs for expenses incurred during the course of performing their work duties. While there is no MAR equivalent, the NICs legislation did include a provision for relief, but it was more complex and this led to different interpretations. This ultimately required a judgment from the Upper Tribunal (UT) to clarify the application of the legislation.

What did the UT case consider?

The UT case in July – *Laing O'Rourke Services Ltd v HMRC; HMRC v Willmott Dixon Holdings Ltd* [2023] UKUT 155 (TCC) – focused on how to interpret reg 22A and the amounts to be treated as earnings in connection with the use of a qualifying car. In particular, the case assessed whether a car allowance paid to an employee to fund a private car can be considered as RME, defined at reg 22A(3). The UT gave RME a wide meaning, encompassing not just actual use, but also 'expected use, potential use and availability for use'. By doing so, this established that a car allowance paid to an employee for the use of a private car is RME and can be brought into scope when calculating the qualifying amount and payments that can be disregarded from earnings for NIC purposes. As HMRC has decided not to appeal the UT judgment, this decision set a binding precedent on how HMRC must interpret the legislation.

What are the implications?

The case may have implications for any employer that provides car allowances. However, it is important to check that car allowances are for the employee to fund a private car made available for business use. This is critical in ensuring they meet the conditions required for RME and therefore are aligned with the UT decision. Some car allowances have lost their identity as employers switch to flexible benefits allowances

covering a range of reward offerings, including provision of private medical and cycle to work schemes. Employers may wish to revisit policies and communication materials to ensure that the purpose of allowances paid is clear.

Where a car allowance passes the RME test, the UT decision clarifies how the legislation applies and can deliver additional relief from NICs for motoring expenses. This clarification further aligns income tax and NICs treatment, and is in line with the general principle on the treatment of business expenses.

Example: An employee receives car allowance of £6,000 per annum and MAPs of 15p per mile for 5,000 business miles. Before the UT decision, most employers would pay the car allowance subject in full to NICs with the MAPS disregarded from NICs as RME. After the UT decision, a car allowance can be RME and disregarded from NICs up to the value of the QA after accounting for the MAPs already paid and disregarded from NICs.

In this example, the employer will be able to disregard £1,500 of the car allowance from earnings for NICs purposes (6,500 business miles x 45p per mile = £2,250, less the £750 paid as MAPs). The amount disregarded here matches the MAR calculated in the example above. The impact of this approach would be a reduction in the secondary class 1 NICs paid of £207 per annum for each employee provided with a car allowance. The primary class 1 NICs paid by employees would be reduced by £180 or £30, depending on the applicable NI category and whether the payment was below or above the upper earnings limit.

What should employers do next?

Following the outcome of the UT decision, there are two key questions for employers:

- Should they submit a claim to HMRC for repayment of NICs paid in error on car allowances?
- Should they change their arrangements to ensure they apply the NICs legislation correctly to car allowances and MAPs?

To decide whether to submit a claim for repayment of NICs paid in error, employers should (a) review the facts of the UT judgement and consider whether their arrangements match the fact pattern and would support a similar claim; and (b) calculate the value of the NICs paid in error that could be reclaimed.

An employer could make an application under SI 2001/1004 reg 52 for repayment of NICs paid in error. HMRC's *National Insurance Manual* (at NIM37000) and Employer Bulletin (October 2023) explain how to approach a claim and correct an employee's NICs.

The application for the return of any NICs paid in error can be made within six years from the end of the year in which the contribution was due to be paid.

Employers may therefore wish to update their policy and communications materials to ensure their car allowances meet the conditions required to be RME. Systems and processes will need to be updated to apply the NICs legislation on an earnings-periods basis. With a monthly payroll and earnings period, employers will need to track car allowance and MAPs to calculate the value of RME paid, the QA and the element of the car allowance that can be disregarded from NICs. ■

The authors' firm advised the appellant in the Laing case.

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► Cases: *Laing O'Rourke Services Ltd v HMRC; HMRC v Willmott Dixon Holdings Ltd* (18.7.23)