
IMPROVING THE TAXATION OF NON-CASH EMPLOYEE BENEFITS

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Abstract:

Every individual is concerned about the influence exerted by the salary compensation on the fair income that he/she is entitled to. In many cases the fiscal policy plays a crucial role in choosing the right compensation alternative. Depending on the position held at a certain company, an employee may be granted by his/her employer a series of benefits: company car, fuel costs, mobile phone charges, subsidized loans etc. – to mention only a few alternatives. Regarding this optimization, the law provisions should be accomplished, but further expected surplus is the main goal. The legislative power is unable to cry off an incentive each time this measure comprise a decline in budgetary policy, no matter its level. The purpose to get back to fiscal competition at individual level remains a nowadays topic and the fulfillment is the essence.

Key words: *income tax, benefits-in-kind, personal allowance, fiscal policy*

1. Introduction

To obtain (and retain) a high-performing workforce, an enterprise must develop a well-conceived compensation program. In addition to a salary, employees may be rewarded with benefit plans, perquisites, bonuses, stock options, and other long-term incentives.

Benefit programs are non-cash forms of compensation employees customarily receive in addition to a salary. Recently, so-called cafeteria or flexible benefit programs have become quite popular. Under such programs, some or all of an employee's benefits are tailored to his or her needs at different career stages.

Also, known as perks, perquisites are extra non-cash forms of compensation. Typical examples include “company car”, “car services”, expense accounts, extra life insurance, supplemental pension programs, club memberships, guaranteed attendance at annual conventions, personal investment counseling, personal legal advice, security protection, low -interest or no-interest loans, and apartments for top – managers. To the extent perks are job-related, they provide employees with nontaxable income, a factor that is particularly important to those in high tax brackets. In addition to offering cafeteria benefits, some enterprises offer cafeteria perks (Bedeian, 1989). These non –cash forms of compensation are used in some counties such as U.S. Table 1 lists some of the more prevalent perks on a continuum according to use.

Table 1. A continuum of perquisites

Most common			Least common
Better appointed office (choice of office furnishings)	Airline VIP lounge	Company plane (personal use)	Company resort
<i>Company car</i>	Extra vacation	Executive dining room	In- town apartment
Company plane (business)	Financial counseling	Home security systems	Legal counseling
Medical exam	Tax counseling	Personal liability insurance	Low-interest loans
Club memberships	First-class travel	Spouse travel	Sabbatical leaves
Business travel insurance	Liberal expense account	Chauffer	Tickets for theatre and sporting events
			Dependent tuition reimbursement

Source: Adapted from W. Gordon Binns, Jr. and Gregory E. Lau, Executive compensation, in AMA Management Handbook, 2d edition, ed. William K. Fallon, New York: AMACOM, 1983, p. 7/57

The paper presents the analysis of application of one of the non-cash forms of compensation (perquisites, respectively company car) in companies from Romania. This analysis was performed considering the fiscal element as a crucial one in achieving staff motivation.

Also is presented the analysis of this form of compensation in terms of tax in UK in order to realize a comparative study.

The Romanian laws that regulate our area of interest are rather permissive, allowing the employer not to overload the gross income, therefore avoiding the

negative effects implied by proportionally higher withheld social security contributions and income tax at an increased level of gross income. We need to underline this issue because it is not enough to lower as much as possible the non-cash benefits; conversely, the non-cash benefits should be appropriately correlated with both the tax rates applicable for the respective employment income and the social security contributions (pension fund contribution, health insurance contribution and unemployment contribution) at a point of time (Tatu et al, 2007).

Furthermore, the policy for checking the real-life situations is rather indulgent. As a result of a verbal agreement between the employer and the employee, the latter will state that he/she uses the company car strictly for business purposes, so there is no possibility of identifying a taxable benefit.

The Romanian taxation self-assessment for such issues is inexistent, by such measure being provided a less difficult measure to conceive the public budget. Even in those situations where the employer takes a step ahead the fiscal framework, the Control Department should have the tools to look up the procedures to enforce the regulations.

2. The Romanian fiscal approach

Although the Tax Code (Bill no. 571/2003) and the adjoining fiscal operating procedures try to define and explain these non-cash benefits, the effectiveness of turning theory into practice is still low (Serbănescu, 2007).

The non-cash benefit which we want to analyze is the company car. The Romanian lawmakers point out that such benefits refer to, among others, the use of goods, including vehicles, regardless of any specification, from the company assets, for personal purposes, except for traveling between the residence and the workplace.

Our research is based on a comparison with one of the most regulated, but in the mean time well-explained tax systems with regard to company car benefits, and this is the British one.

None is able to explain how is possible to create a legal environment, that is both complicated but still able to generate high income flows. In fact is questionable as they continue to work inbounds instead of joining an expat job, well-paid and with multiple possibilities to break into lower tax bracket.

Before starting our analysis, we have to make a clear distinction between the Romanian and the British legal regulations. The first main difference is that the last one considers traveling to the workplace out of the range of business purposes and consequently of personal interest. But instead of limiting this social positive behavior to settle those amounts spend on different means of transportation, they are encouraging the use of employee's one car, meaning an extra expenditure for this one.

In such cases, the mileage proves to be insufficient, so they choose to abandon their own car and switch to public transportation, this declining being similar to an energy save.

The single exception considered in this situations is the company shuttle bus. This segregation must be viewed on a conceptual level, as it is obvious that the use of a shuttle bus arises from the premises that the job description of the respective employee mentions business-purpose travels, in order to serve the goals of his employer.

From my point of view, the Romanian regulations are even-handed, because traveling from the personal residence to the workplace is essentially a business trip, considering that the employee can freely decide on the use of the company car.

On the other hand, setting a fixed travel route should be mandatory, if we are to consider further implications of an accident occurring while traveling to the workplace. According to the aforementioned arguments, a car accident on the way to the workplace is an accident during work. Several consequences could arise from the viewpoint of the insurance companies which provide insurance services to our company, as each event could lead to an upgrade of the riskiness level. This argument provides the incentive for the company to map the desired travel routes, as it is directly responsible for all events along the distance. Any deviation from the previously agreed routes cannot take place without informing the employer; moreover, a maximum time limit should be enforced so that the employee cannot engage in other activities.

In addition, a clear segregation must be made between the use of a company-owned vehicle as granted by the company and the personal use of a vehicle belonging to one's privately held business. The type of the vehicle is also relevant, as vans/shuttle buses are subject to different regulations.

In Romania, the benefit of the free use of a company vehicle is computed at 1.7% per month from the original book value. If the vehicle is rented from a third party, the benefit is computed against the rental fee. The Romanian regulations focus only on the value of the company car, whereas the British regulations makes use of more than one input values.

Two parameters should be taken into account: the list price of the car and the percentage determined by the engine specifications and carbon dioxide emissions. The first step is to multiply the parameters; then the proportion regarding the private use of the company car will be subtracted.

As far as the list price is concerned, there are several similarities to the Romanian system, but up to a certain point only. The basic difference that sets the two systems apart is the employee's contribution to the initial purchase of the car, up to the threshold value of GBP 5.000. First of all is it rather difficult to make any comments as this practice is seldom encountered in Romania, but the analysis should be conducted for every single case, where the input value must be adjusted with the percentage mentioned above.

The percentages aggregate the previously explained inputs and as of the fiscal year 2010 (the fiscal year for natural persons in Great Britain starts on April 6th 2010 and ends on April 5th 2011) are given below:

Table 2: Percentages applied in computing the benefit of using the company car

CO ₂ emissions	Gasoline	Diesel
<76 gram/km	5	8
76-120 gram/km	10	13
121-130gram/km	15	18

Source: www.hmrc.gov.uk

Moreover, for every 5-gram multiple exceeding the upper limit of 130 grams, there is a 1% increase up to the total percentage of 35% (threshold value).

After a 3-year period, the fiscal year 2010 is the first to witness the tightening of regulations: the 1% incremental increase is applicable for a maximum limit of 130 grams, instead of 135 grams as per 2008 and 2009 regulations. The process of steadily lowering the limit is bound to continue in the fiscal year 2011 when the limit will decrease to 125 grams.

3. The approach to tax rates by the use of in-kind-benefits

The Romanian income tax is based solely on a 16% tax rate, which makes even simpler in order to compute different fiscal economies. But the British one consists of a multi-layer system and also takes into account a wide range of income: other income, savings income and dividend income, the specified order being set by law.

A quick look to tables 3 and 4 sets the main differences in the tax rate evolution, depending to the total income. As it can be seen, special rates of tax apply to dividend income and there is also a special rate that is supposed to be used for savings below 2,560 pounds, computed in addition to other income.

Table 3: Income tax rates for FY 2011-2012

Rate	Other income	Savings income	Dividend income
Basic rate	20	20	10
Higher rate	40	40	32.5
Additional rate	50	50	42.5

Source: Adapted by authors according to data published on www.hmrc.gov.uk/rates/it.htm

Table 4: Tax rate bands for FY 2010-2011

Rate	Amount and spread (gross, otherwise grossed up with the withholding tax)
Basic rate band	First 37,400 pounds
Higher rate	Between 37,401 – 150,000 pounds
Additional rate	Over 150,000 pounds

Source: Adapted by authors according to data published on www.hmrc.gov.uk/rates/it.htm

The fiscal competition might be difficult under these circumstances, due to the growing need for revenues derived from personal income tax and corporate income tax. The benefits in kind are comprised in "other income" item, so the higher the amount is, the possibility to reach a superior band grows.

Instead of granting different goods or provide services for their employees, the employer has the opportunity to allow them to become investors by acquiring shares and finally to distribute dividends.

According to the previous two chapters, this thinking is positive as long as the total income is less than 35,000 pounds and the basic rate should be applied, otherwise we are dealing with an erosion of net value for the employee/investor.

The decision has to be brought to light by remembering that dividends are always deemed to have been received net of a 10% tax credit and as a consequence they must be grossed up by 100/90, before including in the tax computation.

CASE STUDY

Two companies, X S.R.L. and Y Ltd. purchase each two cars manufactured by BMW to be used by the top performing employees in both companies in the fiscal year 2010. The timeframe for the fiscal year in each Member State is known (Romania and the UK).

X S.R.L. purchased:

- One BMW 325i with carbon dioxide emissions amounting 168 gram/km for a list price of EUR 39.680 including VAT
- One BMW 330d with carbon dioxide emissions amounting 152 gram/km for a list price of EUR 44.888 including VAT

Y Ltd. purchased perfectly identical vehicles, however, for the more expensive one the employee made a contribution of EUR 2.800 to the purchase (GBP equivalent).

X S.R.L.

The benefits for the cars purchased by the Romanian company are:

$$\text{EUR } 39.680 * 1,7\% / \text{month} * 12 \text{ months} = \text{EUR } 8.095$$

$$\text{EUR } 44.888 * 1,7\% / \text{month} * 12 \text{ months} = \text{EUR } 9.157$$

In Romania the benefit is calculated on a monthly basis, but we choose a 1-year period as benchmark in our comparison between the two countries.

Y Ltd.

The list price for the first car is equal to EUR 39.680. The appropriate percentage in this case is 22% because 15% is the standard rate for gasoline engines, while for the remaining units 7% are added. For automobiles with carbon dioxide

emissions higher than 130gram/km extra units are calculated for each 5-gram multiple exceeding the upper limit.

For this instance the benefit amounts:

$$22\% * \text{EUR } 39.680 = \text{EUR } 8.730$$

The list price for the second car is EUR 44.888 but this amount must be adjusted with the EUR 2.800 paid by the employee. The correct percentage is 22% because 18% is the standard rate for Diesel engines, while the extra units account for the extra 4%. For automobiles with carbon dioxide emissions higher than 130 gram/km extra units are calculated for each 5-gram multiple exceeding the upper limit.

For this instance the benefit amounts:

$$22\% * \text{EUR } 42.088 = \text{EUR } 9.259$$

When we calculate the gross income we have to take into account the social security contributions, as well as the income tax liability. We can easily notice that there are no major differences between the benefit of the Romanian company compared to the British counterpart.

But at the moment of conducting the analysis, we know that the social security contributions total 16.5% in Romania, but these benefits are not subject to these three contributions, leading to an important tax shield.

The next step not to be overseen is calculating the income tax, which must take into account the personal deduction. For the employees of the Romanian company no personal deductions are applicable as the threshold value of RON 3.000 for incurring deductions is exceeded by the benefit solely (roughly EUR 800 per month). However, for the British employees, the personal deductions are not insignificant.

For instance, the basic deduction for employees earning less than GBP 100.000 per year is GBP 6.475. We assume that our top performers are below this value, considering that the limit is still high even for British taxpayers. As a result the taxable income is decreased by GBP 6.475 so that the taxable benefits are greater than GBP 2.000 but less than GBP 3.000.

Under these circumstances, the higher tax rates are offset by the personal deduction resulting in overall smaller taxable income. The final tax liability relies on the income size and the other benefits received by the employee.

The tax rates as of fiscal year 2010 are the following:

- Basic rate of 20% for the first GBP 37.400
- Higher rate of 40% for the income between GBP 37.401 and GBP 150.000
- Additional rate of 50% for the income over GBP 150.000

The final relevant element in our company car benefit analysis, for the scenario of the mixed use of the automobile, the benefit is valued against the distance traveled for private interest as a ratio of the total distance traveled, for the given period of time.

As we can notice, there are many differences between the two legal systems from the tax and benefit perspective. The employee does indeed bear the initial EUR 2,800 cost, but this expense is partially offset by the high personal deductions leading to a lower taxable amount of income.

This analysis must be conducted for each scenario as there are many influencing factors which must be taken into account. One pertinent example is the contribution to private pension funds. We would like to stress upon the EUR 400 limit regulated by the State for private social security (the so-called "Pillar Three") whereas there is no limit for similar contributions in the UK; however, deductions are granted for contributions considered large if compared to the relevant income, as defined by the regulations in use. For example, for a person who does earn any income, a deduction valuing GBP 3,600 related to the contribution is applicable.

4. Conclusions and proposals

A starting point for improving the Romanian system would be calculating benefits by means of a carbon dioxide emissions scale, ultimately serving the purpose of protecting the environment. However, this single criterion does not hold valid, due to price discrepancies at the same level of carbon dioxide emissions.

Actively involving the employee in bearing a part of the list price of the car could be effective only if the fiscal incentive is created to decrease the amount of the taxable benefit.

It is unlikely to witness the implementation of a similar procedure in Romania because the incentives provided by Romanian companies directed towards other benefits. The existence of employees willing to pay a part of the purchasing price of a company car would be an improbable hypothesis.

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