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A close-up photograph of a person's hands. The person is wearing a light green, button-down shirt. Their right hand is holding a silver coin, and their left hand is holding a small, red, textured wallet. The background is a plain, light-colored wall.

Salary sacrifice

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Nearly 30% of employers have adopted salary sacrifice for their pension scheme according to a reward survey from the Chartered Institute of Personnel and Development.

While such arrangements are more popular with larger employers and the private sector, the numbers highlight the impact that salary sacrifice is having.

Even more interesting is what employers are doing with the savings they make on National Insurance Contributions (NICs). Although half of the employers surveyed retain the money generated by the savings, the other half share the savings with their employees.

While savings are a big driver with salary sacrifice, the opportunity to offer a greater range of benefits is also attractive.

This supplement will hopefully provide you with some inspiration if you are considering introducing salary sacrifice.

A handwritten signature in black ink that reads "Cathy Heys".

[cathy.heys@thomson.com](mailto:cathy.heys@thomson.com)

## features

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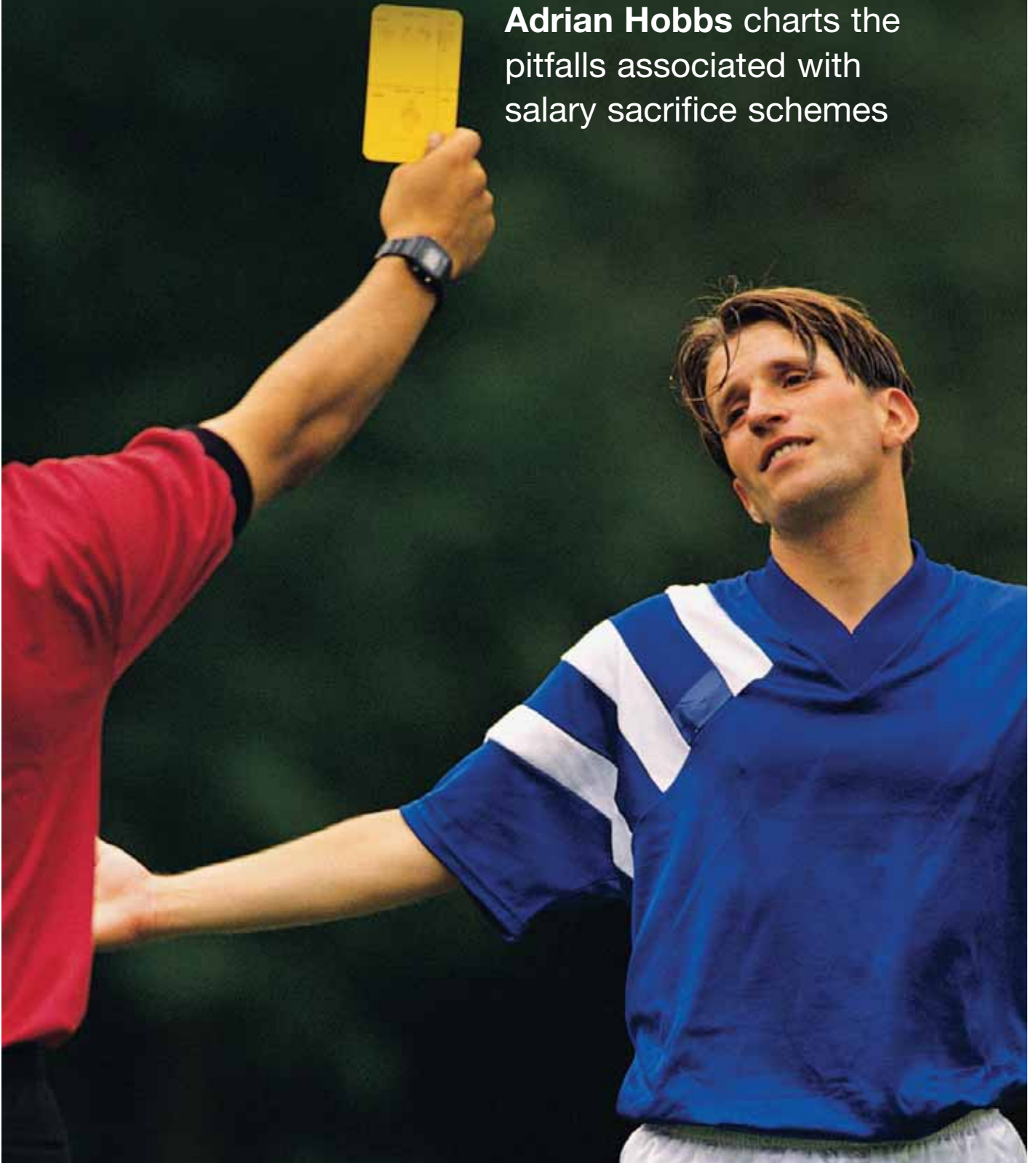
Adrian Hobbs provides a reminder of HMRC's position on salary sacrifice

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Many benefits are suitable for salary sacrifice. Cherry Park looks at the options available and the providers

# Watch out

**Adrian Hobbs** charts the pitfalls associated with salary sacrifice schemes



If a salary sacrifice is not set up and operated properly, the amount of money given up by the employee can end up being still considered as income liable to PAYE tax and NICs.

## Contract variation

For a salary sacrifice scheme to work for PAYE income tax and Class 1 purposes, an employee must give up the right to an amount of their contractual remuneration and this must be done before it can be accepted that a salary sacrifice has occurred (this term should be expressly stated in terms and conditions of employment or in a variation of such terms). The true construction of the revised contractual arrangement between employer and employee must be that the employee is entitled to lower cash remuneration and a benefit.

HM Revenue & Customs (HMRC) will only give an opinion on the efficacy of a scheme once it is put into operation, at which time they will need:

- 1) The contract variation for one employee who has agreed to the changes. If the employer is introducing a number of options, then the contract variation for each different option will need to be supplied.
- 2) The original contract of employment if it is not clear what are the terms and conditions of the employment.
- 3) A payslip before and after the variation.
- 4) The agreement between the employer and the benefit provider, if applicable.
- 5) If the benefit involves pension contributions then information on the pension scheme including whether it is approved and if so its reference number.
- 6) All other documents relevant to the scheme, for example, any booklet issued to the employees as a full guide to the scheme.

## The pitfalls

Salary sacrifice schemes are not acceptable to HMRC where the employee retains control over the money they intended to sacrifice. In this case, the money is earnings of the employee and remains liable to tax and Class 1 NICs.

For example, recently HMRC challenged salary sacrifice schemes

# Salary sacrifice schemes are not acceptable to HMRC where the employee retains control over the money they intended to sacrifice

that are used as a means of providing employees with food and refreshments at work. The amount of salary sacrificed is credited to a card that an employee then uses in works facilities, such as a vending machine, to purchase food and refreshments. However, the card also gives the employee the choice of how much they spend each day, if at all. If food and refreshments are not purchased the employee is effectively provided with credit towards a future purchase. Such an arrangement is not really an acceptable salary sacrifice.

However, if the employee sacrificed an amount of salary on the understanding that the employer would provide a free meal for the employee each day with no credit given for future meals this would likely satisfy the requirements for an acceptable salary sacrifice. For example, the scheme allows the employee a choice of what is on offer that day. If the employee does not have a full meal, or makes a food choice that costs less than the overall amount allowed, or does not have a meal at all, there is no 'refund' by allowing any unspent amount to be carried over to another day. If the employee does not use the provision they lose it.

Some commentators are also worried about some of the childcare voucher provisions that are about. One provider, using a salary sacrifice scheme, allows an employee to vary each month the amount of the vouchers they receive, thus varying the amount of their wages they actually sacrifice on a monthly basis.

It would seem to be all right if an employee does not take their full entitlement one month, but 'banks' their vouchers until they are needed to cover a holiday period. For example, a monthly paid employee agrees to sacrifice £2,915 in wages over the year in order to receive entitlement to £55 a week in childcare vouchers. For the first 13 weeks of the scheme year they do not take any vouchers until a holiday period arrives when they claim 13 weeks at £55 or £715 in childcare

vouchers. However, if the same employee agreed an annual salary sacrifice of £2,915 but then did not sacrifice any salary during those 13 weeks and then chose to sacrifice £715 from their pay in one month to receive that amount of childcare vouchers to cover the holiday period, HMRC might not accept this as being a true salary sacrifice.

There is another problem — if the amount of the wage/salary sacrificed can be taken back at any time, the tax and NICs exemption cannot apply and the cash equivalent value of the benefit provided can be deemed to be equal to the amount given up, which may work to the employee's disadvantage. This means that once a salary sacrifice scheme is agreed, it should remain in place only to be varied, for example, on the anniversary of the scheme. Or, alternatively when specified life-changing events take place — for example, an employee provided with childcare vouchers where the child for whom the vouchers are used dies.

Additionally, there are problems if low-paid employees wish to engage in a salary sacrifice scheme to receive, for example, childcare vouchers. A salary sacrifice must not reduce an employee's wage below that of the National Minimum Wage (NMW). Thus an employee working a 40 hour week at £6.00 an hour could only sacrifice £19.20 a week if their wage were to remain at the NMW rate. That employee could not sacrifice £55 a week despite the fact they earn £240 a week.

Further, a salary sacrifice reduction in wages/salary could have a negative effect on rights to statutory payments and other contributory benefits where the resultant average weekly earnings are less than the lower earnings limit for NICs. Therefore, HMRC are concerned that an employee should not agree to such a scheme without fully realising the effects it could have on their pension rights, entitlement to tax credits, the State Pension and other contributory benefits such as statutory maternity pay. ■

# A fair swap

Exchanging an agreed amount of salary for non-cash benefits is popular with employees, as **Cherry Park** explains

Swapping a chunk of your pay for non-cash benefits while simultaneously saving tax may sound too good to be true for many employees. But this is exactly what salary sacrifice schemes can do, helping employers attract, retain and motivate their valuable staff while saving their organisations money.

Since their introduction in the late 1990s, salary sacrifice, or salary exchange, schemes are being offered by an increasing number of public and private sector employers, including large blue-chip companies such as BT, Tesco and Sainsburys. Not only can the employee save income tax and National Insurance Contributions (NICs), the employer can also save up to 12.8% on its own NICs by offering a salary sacrifice scheme.

A survey by Thomsons Online Benefits, *Employee Rewards Watch 2007*, found that of

those UK companies with employee benefits schemes, 59% have implemented salary sacrifice, a 20% increase since 2006. And the *12th Annual Flexible Benefits Survey* from Hewitt Associates revealed that salary sacrifice now accounts for almost half of all flexible reward schemes.

The components of salary sacrifice schemes have also expanded in scope. Tax-efficient benefits for which employees may exchange part of their gross salary now include pension contributions, childcare vouchers, cycle-to-work schemes, mobile phones, meals at work, bus travel, training, charitable donations, private health plans, car parking, income protection and even carbon offsetting.

## Pensions

In pensions salary sacrifice, the employer

pays extra pension contributions equivalent to what the employee would have paid into a company pension scheme. Basic-rate tax paying employees can increase their pension payments by up to 31% since they are paying less tax and NIC, plus the employer also saves on NICs.

The Chartered Institute of Personnel and Development's 2007 survey on reward management found that 29% of employers operate salary sacrifice for their employees' pension schemes. Of the fifth of employers that made changes to their pension scheme in 2007, 31% introduced a salary sacrifice scheme.

According to David Barker, a principal at Mercer, one of its clients using a pensions salary sacrifice scheme is saving over £1 million per year, while its employees are



saving even more. "In terms of good business practice, there is a great deal of logic in it," he says.

### **Childcare vouchers**

The most popular salary sacrifice benefit, childcare vouchers, can save the employee up to £960 a year in tax and NICs, while the employer saves up to £373 per year per employee at 2007/08 rates.

What else is in it for employers? TV production company Endemol found that using Early Years childcare vouchers has helped improve staff recruitment and retention levels. "More importantly, it has helped us enhance our social responsibility," says Claire Harrison, payroll manager.

"Such a scheme is really encouraging for working mums — and increasingly dads

— to come back to work," she adds." Forty per cent of sign-ons have been new fathers at Endemol.

### **Bikes**

Cycle-to-work schemes are another well-liked salary sacrifice benefit. Through such schemes, employees can hire a bike worth up to £1,000 from their workplace over a 12 to 36 months lease period, at the end of which they can opt to buy the bike for its market value at that time, which is likely to be negligible.

Providers claim that employees can save up to 50% on the retail price of a bike through combined savings on income tax, VAT and NICs. The scheme is part of the government's 'Green Transport Plan' to encourage healthier travel and reduce pollution and congestion. (See

case study, Universal Music).

### **Bonuses**

Employees eligible for a bonus may choose to pay the whole amount into a group personal pension. "Doing this helps them build up their personal pension pot whilst saving them tax and NI," explains Lee Nicholls, employer brand, values and CSR manager at healthcare company Simplyhealth.

Nicholls gives the following example: "If an individual's gross bonus is £1,000, and they are a basic rate taxpayer during the tax year 2007/08, they would receive around £670 (or £590 for higher rate taxpayers) in their pay after deduction of tax and NI. If they chose instead for their bonus to be paid into their personal pension, the entire £1000 →

would be paid in.”

### Communication

Clear communication of a salary sacrifice scheme is vital, regardless of the size of the organisation. Matt Waller is chief executive officer of benefits solutions provider Benefex. He says: “For smaller organisations, face-to-face communication including roadshow events has received very positive feedback. In larger organisations, ensuring that the communication is personalised to the employee, and that they understand the pros and cons of salary sacrifice and any impact on their take home pay, is key.”

### Take-up

Despite the increase in offerings, the take-up of these schemes has not yet been overwhelming. According to Waller, it depends on the benefit type, communication and method used to launch it: “From our market research, the averages are three per cent for childcare and one per cent for bikes. For pension contributions auto-enrolment our average is 92%, while for voluntary contributions it is 45%.” There is obviously some way to go. ■

### Case study: Universal Music

Universal Music first launched its cycle-to-work scheme in October 2005. To date over 12% of the company’s 700 UK employees have joined up.

Wheelies Direct provides Universal with all necessary marketing resources to enable the communication of the scheme to employees. A glossy options brochure provides information on bikes and accessories on offer, while onsite roadshows enable staff to view products at close quarters.

HR director Michael Pye comments: “We were impressed by the simplicity of operation, range of products and customer-friendly approach of the scheme. Wheelies was very helpful in setting up the scheme, arranging the promotional literature and providing representatives on site to explain the scheme to our employees.”

“The scheme proved to be very successful with our employees from both a cost-effective and fitness point of view, and we will be running similar schemes in the future due to popular request,” he adds.

### Case study: Ceridian

HR and payroll services provider Ceridian’s new flexible benefit scheme, FlexAbility, introduced additional voluntary benefits such as Bikes4Work, mobile phones and salary sacrifice pensions alongside its existing childcare vouchers.

Designed with Benefex, the scheme operates through an existing HR portal, which employees use to make their benefit selections at work or home.

The communication of the new scheme aimed to refresh employees’ interest and raise awareness of the new benefits. This was achieved with a 12-page brochure clearly explaining the benefits, the tax and NI savings and the application process, supported by posters, targeted emails, face-to-face HR briefings and roadshows for employees to meet the benefit providers.

Since the revamp, the new offering has generated a 21% increase in employee logon to the benefit online platform and a 17% increase in benefit take up. Ceridian broke even in month six of the scheme and now benefits from a return of investment in excess of 400% year-on-year.

## Salary sacrifice providers

Company	Contact details	Type of scheme	Cost to employer (assume 500 employees)	Details
Accor Services	0845 330 4406 ccvsales@accorservices.co.uk	Childcare vouchers	On request	Online, self or fully managed
Allsave Limited	01256 339 100 info@allsaveuk.com	Childcare vouchers	Low fee	Full, bespoke management
Club-Cycles	028 2565 6000 gabine@club-cycles.co.uk	Cycle2Work	None	Online order and admin process
Cyclescheme Ltd	01255 448 933 info@cyclescheme.co.uk	Cycle-to-work scheme	Cost of bike — paid back by employee	Website for ordering bikes
KiddiVouchers	0845 094 1412 info@kiddivouchers.com	Childcare voucher scheme	Fee of 2.5% of the voucher face value	Fully managed service, eg marketing, registration and voucher ordering
Early Years Vouchers Ltd	0845 0945 805 amanda.ward@childcare-vouchers.net	Childcare vouchers	5% of the voucher value	Web-based system
Equiniti	020 7489 3510 helen.halewood@equiniti.com	Flexible benefits administrator	Dependent on scheme design	Complete outsourced administration
Grass Roots	01442 829 400 andy.lister@grg.com	Salary sacrifice products and management	From £5,000 for a consolidated scheme	Fully managed service
Motivano	0800 019 7375 sale@motivano.co.uk	Salary sacrifice	Set up £1,000 to £4,000	Online and offline support management
Personal Management Solutions	01908 605 0000 krooney@personal-group.com	Voluntary Group Income Protection	Nil	Fully supported service
You at work	020 7699 5506 sally.winter@youatwork.co.uk	Childcare vouchers	5% transaction charge: dependent on requirements	Branded website used to sign up and manage the process
		Cycle-to-work	On application	Bikes stocked at Halfords
		Eat-at-work	On application	