
PAYROLL
BRIEFING

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# SALARY SACRIFICE (OR EXCHANGE)

**What is it, when can it be used and what are the associated considerations?**

## Overview

Salary sacrifice is an arrangement to reduce an employee's entitlement to cash (usually their wage or salary) in return for a non-cash benefit. As a result of a successful implementation, there will be a National Insurance Contribution ("NIC") saving (for both the employee and employer) plus a tax saving for the employee with most of the arrangements. To be effective, an employer has to set up a salary sacrifice agreement by changing an employee's employment contract and the employee needs to agree to the change.

## Implementation of a scheme

For a salary sacrifice arrangement to be effective, the contractual right to cash remuneration must be reduced. This happens with the following;

1. The employment contract is varied and this must be before the employee is entitled to receive the amended remuneration
2. The true construction of the revised contractual arrangement between the two parties must result in the employee being entitled to a lower cash remuneration and a benefit - this is an HMRC anti-avoidance measure to ensure that the arrangement is genuine.

Most salary sacrifice arrangements cover regular payments, but an employee can also sacrifice a one off item, such as a bonus, which is normally sacrificed for a one – off employer pension contribution.

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## Salary sacrifice – why and what?

The main reason that a salary sacrifice arrangement is provided by employers, and agreed by employees, is the saving of NIC for both parties and the potential saving in tax for the employee. The main categories of expenditure where such an arrangement can be implemented are as follows:

- Payments into pension schemes
- Employer provided pension advice
- Workplace nurseries
- Childcare vouchers (commenced pre 4 October 2018)
- Bicycles and cycling safety equipment
- Ultra low emission cars (emitting less than 75g of CO2 per km)

With the exception of pension contributions, where the ultimate tax liability will be the same, albeit the tax relief is received earlier than may otherwise be the case, there is a saving of tax on the sacrificed amount, at the employee's highest rate of tax, and no employee or employer liability to NIC on the amounts sacrificed. As an employer, this is a direct saving of 13.8% of the salary sacrificed (assuming the amount is fully subject to NIC). As a result of this saving, some employers share part or all of this amount with their employees, typically when it relates to pension contributions, and pay an additional employer's pension contribution into the pension scheme.

## Reporting of the benefits to HMRC

Salary sacrifice arrangements can be put in place for any type of expenditure but it is only the categories listed above that are advantageous for tax and NIC purposes. If the salary sacrifice is in respect of a benefit that is reportable under the benefit in kind reporting regime, the value of the benefit is calculated as the higher of:

1. The amount of salary given up (sacrificed)
2. The benefit in kind, as calculated in the normal way

This does not apply to the six categories of expenditure detailed above – in particular, a salary sacrifice arrangement for an ultra-low emission car would generally result in a much higher tax charge were the amount of salary being sacrificed to be taxed rather than the value of the benefit in kind.

## Considerations before entering into a salary sacrifice scheme

Whilst a salary sacrifice scheme is generally seen as a way to save both tax and NIC, there are a few considerations for both employees and employers, which should be made prior to entering such a scheme.

***Employees***
These considerations relate to earnings related benefits, such as maternity allowance and additional state pension, where the employee's entitlement may be reduced as a result of entering a salary sacrifice arrangement. This is also the case for contribution based benefits, such as incapacity benefit and state pension, where the employee's entitlement may be effected as the cash earnings on which NIC are charged are reduced. This is because employees may pay, or be treated as paying, less or no NIC, with the resulting knock on effect on various benefit calculations. Finally, statutory payments, such as statutory pay, can be affected, and being in such a scheme can cause some employees to lose their entitlement altogether. This is where an employee's average weekly earnings are reduced below the lower earnings limit for NIC purposes, and hence there is no basis for statutory payments to be made.

For the majority of employees, these considerations will be outweighed by the savings available, but they should always be considered.

### *Employers*

Employers should make sure that their employees are aware of the implications outlined above when setting up any salary sacrifice scheme and ideally the paperwork should demonstrate that they have made the employee aware of the potential issues. In this way the employees can make informed decisions as to whether they wish to enter into a salary sacrifice scheme.

When setting up such a salary sacrifice arrangement, it is important to note that an employee's earnings must not be reduced below the National Minimum Wage. This is the sole responsibility of the employer to check.

One final consideration, as detailed in the next paragraph, is the potential cost of providing salary sacrificed benefits to employees during their maternity leave, some of which would not be payable (or not at the same levels) were such an arrangement not in place.

## Opting out of a salary sacrifice scheme

As described above, opting into a salary sacrifice arrangement requires a variation to the employee's employment contract. Hence, it follows that if an employee wants to subsequently opt out of the scheme, a variation is again required. To limit the number of times an employee can switch in and out of the arrangement, many employers operate the arrangement on the basis it will remain in place for a period of at least twelve months, subject to a lifestyle change. This minimum period, which is then renewed annually, ensures the employee proactively considers whether they wish to stay in the salary sacrifice scheme. With this review in place, generally an employee can then only opt out of the arrangement if there is a significant lifestyle change, which alters the employee's financial circumstances. These can include:

- Marriage
- Divorce
- Partner becoming redundant or pregnant
- Changes as a direct result of Covid – 19.

As always, it is important that there is a paperwork trail to back up any changes.

## Historic schemes

Where a salary sacrifice scheme was set up before 6 April 2017, rules regarding the reporting of some benefits, namely cars with CO2 emissions of more than 75g, accommodation and school fees, are different to those described above. However, as these differences were only applicable up to April 2021 and hence are no longer applicable (and relatively limited), the details are not given here, but advice can be given if required.

## Conclusions

A salary sacrifice scheme is generally simple to implement and is advantageous for both employers and employees. Whilst there is paperwork to be put in place, once a template is drafted, it is simple to roll out to all employees, and is particularly relevant for pensions, where virtually all employers have to offer a pension scheme to employees under the Auto Enrolment rules.

As with all Government schemes, there are nuances for each category of expenditure and if you are considering implementing a scheme, further advice should be sought to ensure that the scheme is compliant with the various rules. As above, the documentation put in place, and its timing, is critical to a successful salary sacrifice arrangement. Should there be a successful challenge by HMRC, mainly due to the documentation not being in place correctly, the result could be a clawback of the savings made and, at least as a starting point, HMRC will seek reimbursement from the employer.

**Details of each category of expenditure that can be sacrificed, their specific considerations, including for employees on maternity leave, are the subject of separate briefings, to be issued shortly.**

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