SALARY SACRIFICE GUIDE

Salary sacrifice schemes are often presented by employers as a sought-after form of non-cash benefit for their employees.

But sometimes the real reason an employer may wish to introduce a salary sacrifice scheme is because it can indirectly save them employment costs. They may also use it to appear to offer attractive benefits for their workers instead of providing a much-needed increase in salary.

Branches and workplace reps should carefully consider if our members really want such schemes. Will they actually benefit the workers and if implemented, do they understand the implications?

This guidance explains what a salary sacrifice scheme is, the common options used, potential concerns and benefits to workers, and provides a checklist for branches and reps.

What is a salary sacrifice arrangement?

Salary sacrifice schemes mean that an employee gives up part of their cash pay and instead they agree to receive some sort of non-cash benefit.

Most commonly, employers offer the employee the opportunity to take a sum of money directly from their gross pay before tax is deducted, and use it to pay for the cost of items like a bicycle or childcare vouchers spread over time, or to boost their pension contributions.

In return, the employee may receive a 'tax benefit' as their gross take-home pay will be lower. But this tax benefit will only operate if the cash pay is exchanged for specific types of non-cash benefits (see 'common salary sacrifice schemes' below). In these cases, the employee will be paying less in tax and national insurance on their reduced gross amount of take-home pay.

Additionally, the employer may similarly receive a financial benefit. As long as the non-cash benefit the employee receives is exempted by HMRC, the employer will not have to pay employer's national insurance contributions (NIC) on the part of the salary the employee has sacrificed.

In order to set up a salary sacrifice arrangement, the employer must change the terms of the employee's employment contract. The employee needs to agree to this change and it cannot be applied to the salary retropectively.

Although on the employee's payslip it may show a reduction in the gross pay, it does not mean there is an actual deduction in the salary. This is just for the purposes of tax and national insurance contributions.

Common salary sacrifice schemes

Changes made by the Government to salary sacrifice schemes from April 2017, meant that some common schemes lost their tax-free status such as:

- Work related training
- Car parking near the workplace
- Health screening checks
- Mobiles phones, computers and other technology
- Gym membership.

In addition, the following schemes also lost their tax-free status, but if arrangements had already been set up before April 2017 this will be delayed until April 2021 as long as no variation in the scheme is made:

- Company cars with CO_2 emissions of more 75g/km
- Accommodation
- School fees.

If employers take the decision to continue to offer certain salary sacrifice schemes such as those above, employees will no longer receive a 'tax benefit'. However they may still qualify for national insurance savings by being part of a salary sacrifice scheme (although these are small savings in comparison). The employer should confirm the tax and NIC status of the salary sacrifice scheme as determined by HMRC.

These non-tax-free schemes may still be financially beneficial for an employee as the employer may have been able to negotiate a better bulk-buy deal on the item. In contrast to the interest the employee could pay on a commercial loan or hire for the same item, it may also be financially better to purchase the item via such a scheme.

Tax-free schemes

Salary sacrifice schemes that are ‘excluded exemptions’, that continue to offer a tax and national insurance benefit, mean that employers also do not need to value the benefit item nor report to HMRC for a salary sacrifice arrangement. These ‘excluded exemptions’ are:

- Pension contributions and employer-provided pensions advice
- Workplace nurseries
- Other childcare (childcare vouchers for existing claimants, or directly contracted childcare provided by the employer that started on or before 4 October 2018)
- Cycle-to-work schemes, bicycles and related safety equipment – bikes are usually offered as a loan under the salary sacrifice arrangement and then sold to an employee after the end of the loan period at the market value at the time. The exemption from tax and NICs will not apply if any salary sacrifice agreement builds in from the outset an automatic transfer of ownership to the employee at the end of the hire period.

Childcare

Voucher scheme

The tax-free childcare voucher scheme (covering the first £55 a week for basic rate tax-payers) was closed to all new applicants back in October 2018, although existing claimants can continue to use the scheme if still provided by the employer. More than one parent can have applied for the scheme (to double the amount of tax and NI savings) and it covers children up to the age of 15. Parents can choose their own childcare or nursery as long as it is state registered or Ofsted approved.

Workplace nursery

Where the employer has either established a nursery at the workplace or another premise that they manage and finance, it will attract unlimited exemption from charge to tax as employment income and NIC. There is limited exemption on the first £55 a week to other childcare bought directly by the employer for the benefit of their employees.

Tax-free Childcare

Working parents with children under 12 (or under 17 for disabled children), can now open an online account to pay for registered childcare which is tax-free. For every £8 the worker pays in, the Government will add an extra £2 up to £2,000 per child per year (£4,000 per disabled child). Both parents must expect to earn (on average) at least the amount per week that is equal to 16 hours at the national minimum wage rate. However tax-free childcare cannot be used with universal credit, tax credits or childcare vouchers. So if they are existing childcare voucher claimants, they cannot have tax-free childcare as well.

Concerns for some employees

Nearing retirement

Members should be cautious and seek advice from their branch pensions officer about signing up to any salary sacrifice arrangement if they are close to retiring, as this may reduce their take home pay and have implications about the amount of pension they will be entitled to.

Low paid workers

It is important to note the rules around salary sacrifice schemes for low paid workers. Employers must make sure that participation in a salary sacrifice scheme should not reduce an employee's cash earnings (hourly rate) to below the National Minimum Wage. If this is the case then the employee is not entitled to participate in the scheme.

This has historically meant that low paid workers have been exempt from being able to access some workplace schemes, while higher paid colleagues have been able to claim these benefits – a situation that is clearly unfair. The Government reported it as one of the reasons they had cracked down on some schemes as higher paid colleagues were making tax savings on some everyday work-related costs not accessible to the low paid.

In December 2018, the Government sought views on the National Minimum Wage (NMW) rules regarding salaried workers and the operation of salary sacrifice schemes. Results of the consultation at the time of writing are not yet known.

UNISON's response clearly stated our opposition to any proposal to allow workers to be paid below the National Minimum Wage rate if the value of a sacrifice scheme would bring the wage rate below the minimum. The relative clarity of the current position would be lost and replaced with possibly subjective judgements about salary sacrifice benefits that are open to abuse by employers.

Such proposals would also add another layer of complexity to minimum wage enforcement, since each case of underpayment would need investigation for whether salary sacrifice benefits can justify underpayment of the hourly wage rate.

By muddying this principle of calculating the minimum wage on the basis of gross pay, but before supplements such as overtime etc, any such proposal would represent a dangerous departure from the philosophy of the National Minimum Wage.

Variation of employment contract

An employee's terms and conditions of employment relating to pay are varied as part of a salary sacrifice arrangement. Employees need to be clear about what these changes are and how long they will go on for, and agree fully to the changes.

It would be rare for a scheme to run for less than a 12-month period and often longer is stipulated by the employer. The employee must have a choice about whether or not to join the scheme, preferably with an option to opt-in rather than to opt-out.

Employees should be provided with some written confirmation of this variation to their contract of employment.

Impact on how calculations are made for other benefits

It is important to clarify how the employer calculates annual pay rises, redundancy payments, overtime and other supplementary pay rates, as well as pensionable pay. This should ideally be based on the salary level before the salary sacrifice came into effect (often called the notional salary), rather than at the new reduced rate, so as not to disadvantage those employees participating in the arrangement.

This will need to be negotiated with the employer but calculating it using the notional salary will not affect the tax and NIC status of the salary sacrifice benefit.

It is particularly important that enhanced family leave payments such as contractual maternity and paternity pay are calculated using the notional salary level.

However the reduced salary level does have to be used for the calculations for a worker's statutory payments (such as statutory maternity, paternity, shared parental, adoption and sick pay), not only affecting the average weekly earnings during a relevant period, but for some low paid workers, bringing it below the lower earnings limit for national insurance contributions purposes (set at £118 per week for 2019-2020 and normally reviewed each year). This could rule out their eligibility for some statutory payments.

The reduced amount of national insurance contribution can also affect the level of state pension that the employee is entitled to.

To compensate affected workers, it would be important to try and negotiate a non-statutory 'top-up' payment from the employer to cover any loss as a result of the salary sacrifice arrangement.

Workers also need to be made aware that the reduced salary level may impact on calculations based on salary as used by mortgage lenders and credit card companies. Similarly if life cover is provided, employers generally work out the entitlement as a multiple of salary and salary sacrifice will make that salary seem lower.

Personal circumstances change

As opting into a salary sacrifice scheme means a variation in the employment contract, it is likely to tie the employee into a set period of time, usually at least a year. The employer may have to comply with HMRC rules and remove the tax and national insurance contributions advantages should the employee repeatedly swap between cash earning and a non-cash benefit whenever they like.

HMRC does however has some exceptions to this. Personal circumstances can change, and a significant 'lifestyle change' – as HMRC calls it – may mean that suddenly cash in the bank is needed more than the non-cash benefit by the employee. HMRC does not define 'lifestyle change' but it could be circumstances such as marriage, divorce, a partner becoming redundant or pregnancy.

UNISON's Health care service group conference in 2010, carried an amended motion that highlighted an issue of salary sacrifice schemes set up by private contractor employers for pension contributions. Whilst the employer makes national insurance contribution savings they were found to be unlikely to invest them for the benefit of the majority pension scheme members.

The motion stressed the need to offer a real, informed choice to employees on whether or not to join the scheme by providing each pension member with an opt-out form, as part of the consultation process and not to discriminate against those who do choose to opt-out.

A clear commitment from the employer was also needed that for members who choose to participate in a pension salary sacrifice scheme, overtime rates, holiday pay, bonus payments, statutory maternity/paternity/adoption and sick pay etc. will not be affected by the reduction in gross salary.

Potential benefits for some employees

What savings can be made from using a salary sacrifice scheme?
The savings to be made depends on what rate of tax the worker pays and how much of their salary they are sacrificing. But for a basic rate tax payer (charged at 20%) if they salary sacrifice £100 of their earnings, they can save £20 in income tax and £12 in national insurance contributions.

For a higher rate tax payer (charged at 40%) they can save £40 in income tax and for an additional rate tax payer (charged at 45%) they can save £45 in income tax, as well as £2 in national insurance contributions.

The example below (from the Which? website) indicates how calculations are made in a pension salary sacrifice scheme, improving the pension contribution made for that employee.

Checklist

- ☐ Is the salary sacrifice scheme not compulsory?
- ☐ Is the salary sacrifice arrangement on offer to all employees? This is a requirement for any cycle-to-work scheme for example.
- ☐ Has the employer highlighted all the benefits of the scheme on offer, particularly if it is in relation to pension contributions?
- ☐ Do members opt in to the scheme or can they opt out?
- ☐ Does the employer provide written confirmation of any variation to individual contracts of employment when they opt in or out of a salary sacrifice arrangement?
- ☐ Is it clear if the benefit provided through the scheme is tax-free and national insurance contribution-free or not?
- ☐ How will the employer use the savings they make in lower employer national insurance contributions? For example will the employer add the savings they make to the total pension contribution amount they pay?
- ☐ Will low paid workers not be able to join the scheme as it means that their wages after salary sacrifice arrangements will fall below the national minimum wage?
- ☐ Will joining the scheme for workers on the lower wage level mean that after salary sacrifice their wage will fall below the lower earnings limit for national insurance contributions purposes (set at £118 per week for 2019-2020)?
- ☐ Will the salary sacrifice scheme impact on entitlement to holiday pay and bonuses, or will they be calculated separately using the higher rate of pay before the salary sacrifice arrangement?
- ☐ How are earnings related payments such as occupational pension contributions, overtime rates and pay rises calculated? Using the higher rate of pay before the salary sacrifice arrangement?
- ☐ Does the employer calculate employer and employee workplace pension scheme contributions based on the notional level of pay before the salary sacrifice arrangement?
- ☐ How are earnings related payments such as contractual enhanced maternity and paternity pay and paid carer's leave calculated?
- ☐ Are any statutory payments, such as statutory maternity or sick pay affected by the lower salary rate?
- ☐ Does the employer allow changes to the salary sacrifice arrangement with individual employees where a 'lifestyle change' significantly alters an employee's financial circumstances? Does this comply with the HMRC requirements so as to continue to benefit from the tax and national insurance contributions advantages?

- ☐ If workers are adversely affected as a result of the salary sacrifice arrangement, will the employer provide a top-up payment to compensate them any loss?
- ☐ Are workers aware of how the salary sacrifice arrangement may or may not impact on salary levels used to calculate mortgages and other loans?
- ☐ If arrangements for salary sacrifice schemes for company cars, accommodation and school fees set up before April 2017 are continuing, do employees know that they will no longer receive a tax benefit after April 2021?
- ☐ If a salary sacrifice scheme is to be stopped, is the employer considering replacing it with another benefit such as increased annual leave? Or instead increasing all employees' basic pay?

For further help in negotiating salary sacrifice schemes, contact your **regional officer** www.unison.org.uk/regions.

Also contact your **regional education teams and / or LAOS** to find out what training and resources are available to assist you with negotiating with your employer or promoting the issues in this guide with your members https://learning.unison.org.uk/.

Further guidance on pay and other workplace issues is available from the bargaining support unit www.unison.org.uk/bargaining-guides.