PES viewpoint

Salary sacrifice: the future

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Welcome to Optional Remuneration Arrangements

The Finance Bill 2017 introduced changes to salary sacrifice (or salary exchange), the voluntary means of paying for employee benefits via a reduction in gross income. We have HMRC to thank for a thrilling alternative: Optional Remuneration Arrangements (OpRAs). Here we explain what these changes mean for employee benefit schemes.

Since April 2017, HMRC seems to have removed the term salary sacrifice completely from its vocabulary. Instead, we've been introduced to OpRAs, a mechanism for calculating the taxable value for certain benefits in kind. The voluntary payment arrangement formerly known as salary sacrifice, or salary exchange, appears to be no more.

But is that really so? Well no, actually. For certain benefits, salary exchange (and its associated tax relief) is still around, and works exactly as it always did. OpRAs may have replaced it for some benefits but only for tax purposes. We predict that the funding of voluntary benefits will still be referred to as salary exchange in legal, HR and other real world circles for many years to come.

How salary exchange works

So let's remind ourselves how salary exchange works. This is a voluntary arrangement that allows employees to pay for the benefits they choose via a **reduction** in salary, usually over a 12-month period. With some benefits, the reduction to gross salary after the benefit payment is taken means that the employee will pay less tax and/or National Insurance (NI).

Under this arrangement, employers need to pay for the cost of the benefit initially, while the employee pays the amount back gradually over the repayment period. So employers need to factor in the upfront cost of some benefits for cashflow purposes. Let's take a bike, for instance.

Example: Cycle to work scheme

You provide a cycle to work scheme which allows your staff to buy a new bike and accessories. The cost of the bike is £600. You pay for the bike upfront, while your employee pays the money back at the rate of £50 per month (with a 12-month agreement), which is covered by a reduction in their salary.

Your employee pays tax and NI on their salary minus the £50 per month. You also pay less employers NI, based on the reduction in gross salary.

Employee salary	£24,000
Monthly gross salary	£2,000
Value of bike	£600
Monthly payment	£50
Monthly gross (taxable) salary	£1,950
Tax saving: £50 @ basic rate tax 20%	£10 pcm
NI saving: £50 @ 12%	£6 pcm
Employer NI saving: £50@ 13.8%	£6.90pcm

In this case, the benefit is like an interest-free loan for your employee. But it offers tax advantages for both of you.

Benefits still eligible for tax relief

Several key benefits are still tax-exempt, so with these, salary exchange works exactly as it always has.

Pension contributions

Pension advice

Childcare vouchers

Cycle to work schemes

Ultra-low emission cars

Registered group life schemes
(considered to be a registered pension scheme)

The Finance Bill 2017

Since the Finance Bill became law in April 2017, the number of benefits that attract tax relief has been pared down. The benefits listed below are now subject to tax when they are paid for voluntarily through a reduction in salary (there are other ways to fund benefits, as we'll see later).

Benefits that no longer attract tax relief

- Health screening
- Company cars (other than ultra low-emission cars)
- Car parking at or near a place of work
- Some of the mobile phones, computers and tech schemes (where ownership remains with the employer)
- On-site gyms
- Living accommodation
- Certain school fees
- Any group life cover provided outside a registered arrangement
- Group income protection

What's changed for taxable benefits?

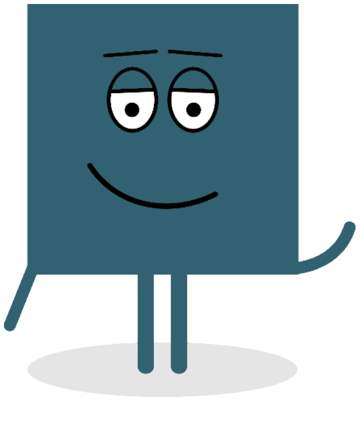
So what exactly is the new tax position of these benefits? They are now treated like any other benefit not eligible for tax relief, but with some interesting new terminology.

Optional Remuneration Arrangements

The general way that HMRC establishes the taxable value of non-exempt employee benefits is to give them a 'cash equivalent'. There is much legislation and case law setting out how this is calculated for each benefit. Prior to April 2017, these rules applied to voluntary benefits (funded via salary exchange) and to company paid benefits. However, the introduction of OpRAs in Aril 2017 has changed all that.

Under the new rules, salary exchange has been replaced by OpRAs (at least for tax purposes), which are defined as 'arrangements under which employees give up rights to receive an amount of earnings in return for a benefit.' It may sound like pretty much the same thing, but don't be fooled – in HMRC-speak there can be a difference.

First of all, the terminology has changed. Instead of talking of the cash equivalent, HMRC now refers to 'the amount foregone' – or the amount of earnings given up to receive the benefit.



Secondly, 'the amount foregone' may be the same as the (former) cash equivalent – or it may not. In straightforward cases (such as a private medical insurance premium costing £500 per year), it will be the same (in this case £500). If the benefit in question was never eligible for tax relief, then there is no change to its tax treatment.

But if the benefit is an asset which belongs to the employer – such as a computer – things are slightly different. Let's take the example of a company laptop, which the employee opts to pay for through a reduction in salary, or an OpRA.

Example: Use of a company laptop

Under the old rules, use of a company laptop or other technical equipment might have been valued as a percentage of the cost of the asset, normally 20%. This means that for a laptop worth £1,200, the cash equivalent would only have been £240.

Cost of laptop	£1,200
Monthly gross salary	£240

Tax would have been payable on £240 at the appropriate rate.

Now the taxable value, or the amount foregone, is equivalent to the actual value of the laptop, giving no tax advantage.

Cost of laptop	£1,200

Tax is payable on £1,200 at the appropriate rate, but employees do not pay NI.

Employers have to pay Class 1A NI on the amount foregone, but employees still don't have to pay NI, so there is a slight saving to be had.

Check your scheme arrangements because some cases, an asset like a laptop will have been transferred immediately to the employee, who would have paid tax on the total value. In such cases, there is no change going forward.

Rules don't change overnight – for most benefits, the new rules will apply at the renewal date. For some, where arrangements existed pre-April 2017, there is a longer period of transition (such as company car schemes). Take advice from your benefits adviser if you find yourself in this situation.

The fact is that a relatively small number of benefits are affected, and the new rules won't change the world for many organisations. Most of the tech schemes offered by PES aren't affected because they weren't set up that way.

Other ways to fund benefits

It's important to remember that up until now, we've been talking about employee benefits paid for via a reduction in salary. But this isn't the only way to fund them. Alternatives to salary exchange or OpRAs are still used, and the good news is that for some of these options, the tax position hasn't changed at all.

Let's have a re-cap on the other ways in which benefits are typically funded.

A benefit fund (sometimes called a 'flex pot')

A benefit fund is a sum of money which you give to each member of staff. They can spend it however they like on a range of products, selected from a list determined by you. If you offer these benefits via an online platform, you'll make it really easy for employees to see at a glance what's on offer and how much they have to spend. You'll also be able to communicate with them quickly and easily, and measure accurately just how well people are engaging with your scheme.

A benefit fund gives employees:

- a great selection of benefits to choose from – to boost their health, save money efficiently, look after their loved ones, or simply enjoy life more
- flexibility to choose benefits that match their lifestyle and interests
- greater motivation to take up the scheme and enjoy it.

It gives you freedom to:

- set the fund to match your budget (although make sure it has enough for staff to buy at least one or two benefits)
- increase the fund (or not) at different rates to your normal pay review – which can be a handy way to help soften the blow when pay rises are low or non-existent (and benefit funds don't need to be included in pensionable pay, so you're not obliged to make employer pension contributions on any increase)
- level the playing field by offering the same amount to every employee (although you can use different value funds for different levels of the organisation if you want something extra for senior staff)
- offer the fund on a 'use it or lose it' basis so that it's divided into a monthly spend which encourages people to get involved with the scheme (although of course if they don't, you'll save money)
- pass on any increases in provider premiums and/or Insurance Premium Tax (IPT) to the employee to pay for out of their fund, helping you to manage/fix budgets.

Core employee benefits

Core benefits are paid for by you as part of the employee total reward package and typically include products like life assurance or private medical insurance. They are a straightforward cost to the business, but with a good return. You can provide these benefits for all of your employees, or just for a selected group. Often they are perceived as important additions to salary, and in some sectors they make the difference between attracting the top talent or losing star players to the competition.

Choosing a broker who's focused on giving you a high quality, personalised service will give you competitive group rates for products that are a good fit for your organisation.

Few business owners have the time to search the market for competitive pricing, product suitability and appeal to their workforce. The best brokers will make sure your investment works as hard as your employees.

A benefit fund, core benefits and voluntary arrangements can be combined if this works well for your business. See our accompanying paper, How benefits are funded, for more detail on this.

Core benefits are often perceived as important additions to salary

The tax position

If you provide taxable benefits directly as core benefits, or if they are taken up via a benefit fund where no cash exchange is offered, there is no change to the way they are treated for tax purposes post-April 2017. The 'cash equivalent' method of calculating the tax value of the benefits still applies, and where there were tax advantages before, they still exist.

This increases the value of a benefit fund and makes popular, valuable benefits like health screening or parking eligible for tax and NI savings – provided there is no cash option instead of the fund.

You can get better value premiums for employees with group insurance schemes

There is no change to the tax treatment of benefits provided directly as core benefits, or as part of a benefit fund that cannot be exchanged for cash

Changes at a glance

In essence, of the three main ways in which benefits are funded, the only one to really feel the change post-April 2017 is salary exchange.

Type of funding	Impact post-April 2017
Core benefits not redeemable for cash	No change
Benefit fund not redeemable for cash	No change
Salary exchange for benefits that still attract tax relief	No change (see list on page 4)
Optional Remuneration Arrangements (benefits in kind paid for through salary but not tax-exempt)	Taxed at the appropriate rate on 'the amount foregone'. Employer pays Class 1A NI. Employee pays no NI.

Core benefits are unaffected, provided there is no cash alternative. So are benefit funds that can't be exchanged for cash. Benefits paid for voluntarily through salary exchange are only impacted if they are no longer tax-exempt.

Some final thoughts

Many of our clients have not been affected by the changes introduced in the Finance Bill 2017. This is because we design our benefit schemes with potential business gains in mind, rather than the prospect of tax savings. So remember:

- tax relief shouldn't be your first consideration when it comes to offering employee benefits
- there are so many other advantages, from increasing employee motivation and loyalty, to offering a more competitive recruitment package and enjoying greater staff retention
- if you're not sure where you stand following the recent changes, or even if you are, it's always worth reviewing your benefit offering and how it's funded.

Focus on value for money and good business returns. Then whatever the chancellor tries to claw back into the benefit tax coffers each year is unlikely to worry you too much.

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