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Salary Sacrifice and Employee Benefit Packages

Following the Autumn Statement 2016, from April 2017 there will be a change to the way benefits in kind are treated where they are provided via salary sacrifice (or if the employer offers a cash alternative). Most benefits will be chargeable to income tax and employer NI contributions even if in the past they have been exempt. However, there will be no change to the tax and NI contributions advantages of salary sacrifice arrangements for key benefits such as pension saving into a registered pension scheme.

Autumn Statement 2016 Changes

The government announced in the Autumn Statement 2016 that legislation will be introduced in the Finance Bill 2017 to remove the income tax and employer National Insurance (NI) contributions advantage of providing some benefits in kind through salary sacrifice schemes or where the employee can choose between a cash allowance and the benefit in kind. The legislation will apply from 6 April 2017.

Most benefits in kind are currently exempt from employee NI and this will continue post April 2017. Benefits in kind given on top of salary will not be affected by the changes nor will flexible benefit arrangements where there is no choice between the benefit and cash.

The legislation will introduce a rule to value all benefits in kind at the higher of the cash foregone or the current taxable value whilst disapplying exemption provisions. The benefit in kind will become chargeable to income tax and a corresponding Class 1A NI liability will arise for the employer on that same amount. This will also remove any advantage where the taxable value of the benefit in kind is lower than the cash foregone.

From April 2017 salary sacrifice arrangements are to be defined as optional remuneration arrangements in the Income Tax (Earnings and Pensions) Act 2003. There are two types:

- Type A arrangements occur when earnings of the employment (or a future right to such earnings) which would otherwise be taxed as earnings are given up in exchange for a benefit.
- Type B arrangements occur when an employee is offered the alternative of a benefit or a cash allowance in lieu of the benefit. Where the cash allowance is chosen, that is already taxable as earnings. From April 2017, where the benefit is taken instead, it will be valued at the level of what the cash allowance would have been.

Where the benefit in kind is provided by an optional remuneration arrangement any existing exemptions will no longer apply unless they are deemed to be special case exemptions or excluded exemptions.

The following are examples of excluded exemptions (listed in the draft provisions for the Bill issued on 5 December 2016):

- Contributions to registered pension schemes in respect of an employee.
- Death or retirement benefit provision (under a registered pension scheme or otherwise (e.g. excepted life policy)).
- Employer-supported childcare and provision of workplace nurseries.
- Cycles and cyclist's safety equipment provided under the cycle to work scheme.
- Employer-provided pensions advice.
- Contributions under a qualifying overseas pension scheme in respect of an employee who is a relevant migrant member of the pension scheme.

So the current exemptions for childcare vouchers, employer provided pension contributions, workplace nurseries, cycles and cyclist's safety equipment will continue to apply under salary sacrifice arrangements.

Provision of appropriate independent advice in respect of conversions and transfers of pension scheme benefits where their nature will change from being a safeguarded benefit into a flexible benefit is listed in the special case exemptions.

Current contracts will remain under the pre-2017 rules until the contract ends, is modified or changed or is renewed, or April 2018 at the latest. Where an arrangement is in place on 6 April 2017 for cars other than cars with emissions between 0 and 75g CO_2 per kilometre (Ultra Low Emission Vehicles (ULEVs)), accommodation or school fees, these arrangements will be 'grandfathered' until renegotiation, revision or renewal, or by 6 April 2021, whichever is sooner.

From 6 April 2017 only ULEVs will continue to benefit from the employee's NI saving.

The exemption for employer-provided pensions advice from 6 April 2017 is new.

Intangible benefits such as annual leave or variation in working hours are not affected by Autumn Statement 2016. They are not taxed and do not rely on a specific exemption.

Impact on Employee Benefit Packages

Benefits Effectively Not Impacted by the Changes

Benefits in kind that are **currently exempt from only employee NI contributions** will continue to be treated as now:

- The benefit will be subject to income tax and employer NI contributions.
- Where the benefit is provided through salary sacrifice, the employee will save on the employee NI contributions on the salary foregone.
- Benefits covered by this include private medical, dental, critical illness, and travel insurance.

Benefits in kind that are **currently exempt from all of income tax and employee / employer NI contributions and will have an exclusion post April 2017** will be treated as follows:

- The benefit will continue to be exempt from income tax and NI if provided as a benefit on top of salary.
- Where the benefit is provided through salary sacrifice, the employee will save on the employee NI contributions on the salary foregone.

- Where the benefit is provided through salary sacrifice and is **excluded**, the benefit will continue to be exempt from income tax and employer NI contributions will be payable. See page 2 for examples.

Benefits Impacted by the Changes – Benefits Not Covered under an Excluded Exemption for Salary Sacrifice

Benefits in kind that are **currently exempt from all of income tax and employee / employer NI contributions and do not have an exclusion post April 2017** will be treated as follows:

- The benefit will continue to be exempt from income tax and NI if provided as a benefit on top of salary.
- Where the benefit is provided through salary sacrifice, the employee will save on the employee NI contributions on the salary foregone.
- Where the benefit is provided through salary sacrifice and is **not excluded**, the benefit will be taxable and employer NI contributions will be payable. This includes common items such as gift vouchers, health-screening assessments, mobile phones, gym membership and car parking spaces. Also included would be sick pay provided under an insurance policy.

Areas of Concern

Excepted Life Assurance

We are currently aware that there is some doubt as to whether excepted life assurance policies will be covered under the excluded exemptions detailed above.

Group Income Protection

We are also aware that as it stands group income protection would be effectively double-taxed where it is provided under a salary sacrifice (or flexible benefits) arrangement.

We understand that representations have been made to HMRC to resolve and clarify both these areas of concern.

Conclusion and Actions

Employers will need to review how they provide benefits for their employees but flexible benefit arrangements including salary sacrifice will still be an attractive way of providing benefits that the employee cannot otherwise access or where the employer can get better terms by virtue of the group nature of the benefit and/or the employer’s buying power. There will continue to be an employee NI saving.

Employers operating salary sacrifice or flexible benefits arrangements, particularly those which are due to go live or renew in the next three months, should take advice (tax and legal) on the impact of this new legislation. The difficulty is that the legislation is unlikely to be passed before April 2017.

It may be appropriate to change how benefits are provided (e.g. by making them voluntary).

Questions to consider include: Will the arrangement be compliant? Will it be viable to continue with the arrangement if the benefit will not be covered by the excluded exemptions? What changes will be needed to communication materials to clarify any change in income tax for employees? Should ‘flex-down’ options be limited or removed if they adversely affect those who do not do so?

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