

Salary Sacrifice Arrangements

What is a salary sacrifice arrangement?

A salary sacrifice arrangement involves an employee giving up part of their entitlement to salary which is subject to income tax and National Insurance contributions (NICs), in exchange for a new or enhanced non-cash benefit, which benefits from a full or partial exemption from tax and/or NICs.

What are the most commonly used salary sacrifice arrangements?

Employer-supported childcare

Two forms of employer-supported childcare benefit from exemption from tax and NICs:

- Childcare vouchers provided by the employer for qualifying childcare (the exemption covers the first £55 a week, equivalent to £243 a month).
- Directly-contracted or employer-contracted childcare, where an employer arranges for the provision of qualifying childcare (again, the exemption covers the first £55 a week).

In addition, childcare facilities provided by an employer on site are usually entirely exempt from tax and NICs without limit.

Provided the conditions for exemption are met, your employees will save tax and NICs on the salary sacrificed. For childcare vouchers, assuming the full amount is sacrificed, earners who pay tax at 40% will make a combined tax and NICs saving of £1196 a year. Your business will be able to save up to £373 a year for each employee via reduced employer NICs.

What conditions have to be met for the childcare voucher exemption to apply?

- The voucher must be for childcare for a child (or stepchild or person under the parental responsibility) of the employee.
- The voucher can only be used to obtain qualifying childcare (this means the carer must have the appropriate registrations and approvals).
- The vouchers are available to all of the employer's employees.

From 6 April 2011, new joiners will only be entitled to basic tax relief. However, higher and additional rate taxpayers who participate in such schemes will continue to enjoy higher or additional rate relief.

Cycle to work schemes

The cycle to work scheme allows your business to loan cycles and cyclists' safety equipment to employees as a tax and NIC-free benefit. This means your employees will save tax and NICs on the salary sacrificed and your business will save employer's NICs.

What conditions have to be met for the cycle to work exemption to apply?

- The cycle and/or the equipment are loaned to the employee.

The exemption is **not** available if the agreement between your business and your employee provides for the automatic transfer of ownership of the bike to your employee at the end of the hire period.

- Your employee uses the cycle and/or the equipment mainly for qualifying journeys.
- The cycles and/or equipment are available generally to your employees.

HMRC has confirmed that if there are employees who cannot participate in the scheme (because, for example, a salary sacrifice would take the employee below the national minimum wage), your business could make a pool of bikes available. As long as the pool of bikes was large enough, the condition would be satisfied.

As your business will be lending the bike to your employee, a formal hire agreement is required. However, if the value of the bike and/or equipment is not more than £1,000 (including VAT), you will not need a separate consumer credit licence as it will be covered by the group licence issued by the Office of Fair Trading.

At the end of the hire period, your business can sell the bike and/or equipment to your employee. This will be a taxable supply for VAT purposes. If you sell the bike and/or equipment to your employee for less than market value, it will create a taxable benefit on which income tax and Class 1A NICs are payable.

Enhanced employer contributions to registered pension schemes

Salary sacrifices to increase pensions contributions and save NICs

When an employee makes a pension contribution from salary actually paid, there is no NIC saving because employer and employee NICs are calculated on gross earnings. However, by replacing an entitlement to an amount of salary with an entitlement to an employer pension contribution, gross earnings are reduced, which reduces both employer and employee NICs. As there are no employer NICs on employer pension contributions, implementing a sacrifice scheme is an attractive way for your business to make NIC savings.

At current rates, most employees will save NICs at only 1% by using the sacrifice route instead of by making an individual contribution to the pension scheme. However, your business' savings are likely to be much greater, currently 12.8%. Your business can pass on some or all of the saving by way of a higher special pension contribution. A fairly common arrangement is to share the NIC saving 50:50.

Other possible attractions of salary sacrifice to increase pensions contributions

- The simplicity and cost efficiency for your employee of using a pension scheme already set up by the employer. In some schemes, the rules of the scheme limit the amount an employee can contribute. A salary sacrifice increases your business' contributions for a particular employee, not the employee's contributions. A salary sacrifice arrangement avoids the need for employees to set up their own pensions arrangements if they want to make contributions in excess of the scheme limits.
- The level of the working tax credit and child tax credit available to low or middle earnings employees may be increased by a salary sacrifice arrangement. However, your employees will need to be warned that state benefits can be reduced if the salary is sacrificed in return for certain employer benefits.

More information

If you have any questions about the content of this checklist, please contact Helen Peach on 01435 898058 or email her at helenpeach@armsworthalexander.com .