Salary sacrifice: what's changed?

A practical guide for SMEs on managing the upcoming salary sacrifice changes

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Scrapping salary sacrifice schemes: Another barrier set by the Government

Chris McClellan, chairman and CEO of RAM Tracking, explains why the upcoming changes will come as a major blow to SMEs.

2017 is likely to be a difficult year for SMEs. Brexit uncertainty remains a disruptive factor and the weaker pound combined with rising costs are bound to undermine plans to invest.

Facing this uncertainty, employers will be doing all they can to keep operations steady and employees happy, ensuring that it's 'business as usual'. Therefore, when Chancellor Philip Hammond announced late last year that the Government will be scrapping most salary sacrifice schemes, it came as a major blow to many businesses who regard such schemes as vital to attract and retain talent.

Losing this tax-free benefit, along with the Apprenticeship Levy, is another barrier that could significantly hinder growth and expansion for small and medium-sized businesses. Although Parliament is not seeking to penalise SMEs, these new changes will hit them the hardest as they will not have the same financial or human resources as larger firms to implement new processes and systems.

There are big changes ahead for SMEs and they will bring financial, tax, legal and HR implications. By seeking support now and investing in technology, business leaders could not only overcome any obstacles but could find themselves better in the long-run.

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CHRIS MCCLELLAN
CHAIRMAN AND CEO AT
RAM TRACKING

So, what's changed for salary sacrifice schemes?

In his first-ever Autumn Statement in November 2016, Chancellor Philip Hammond announced significant changes to how salary sacrifice schemes will work. Many popular schemes - which allow both the employee and the employer to reap tax-saving benefits - will have their perks axed as of April 2017, causing potential disruption and complications for both SME business owners and their staff.

Why are salary sacrifice schemes so popular with SMEs?

A salary sacrifice scheme allows an employee to give up part of their salary in return for a non-cash benefit, such as childcare vouchers or gym membership.

When a worker accepts a salary sacrifice their pay is reduced, which then lowers the amount of tax and National Insurance paid. The employer also benefits, as they will not have to pay their Employers' National Insurance contributions on the amount the employee sacrifices.

What will change in April 2017?

The Government will scrap tax perks on most salary sacrifice schemes from 5 April 2017. By removing the tax-saving benefit, it means that these perks will be subject to the same tax as cash income.

Those current schemes that will have their benefits stopped are:

- Company cars (unless they're ultra-low emission vehicles)
- Work-related training
- Car parking near the workplace
- Health screening checks
- Mobile phone contracts, computers and other tech
- Accommodation
- Gym membership
- School fees

There are however, four schemes which will continue to receive their tax-saving benefits, with the Chancellor making this decision as they align with the current political agenda. These are:

- Pension contributions
- Childcare
- Cycle-to-work schemes
- Ultra low-emission vehicles

What are the key dates?

Despite the changes, if an employer would still like to set up a soon-to-be-axed salary sacrifice scheme for a worker, they would need to do so by the 4th April 2017 to ensure they can keep the tax-saving perks for a while. Most schemes set up before this date, including those that are already in place, will keep their tax benefits until April 2018 – a date put in place by the Government to allow sufficient time for them to be phased out by businesses. Those schemes relating to company cars, accommodation or school fees will keep their benefits until April 2021.

Whilst at first these changes may seem challenging for SMEs, ensuring employers are clued up on the legal, tax and HR implications, the process will be as seamless as possible for management and staff alike.

Salary sacrifice: A finance director's perspective

How to reduce disruption whilst maximising talent retention

James Monks, finance director at RAM Tracking, discusses alternative solutions for employers now that most salary sacrifice schemes will be losing their tax-saving benefits.

The last few years has seen a significant increase in the adoption of salary sacrifice schemes by employers. Much of the popularity of these schemes can be explained by their mutually-beneficial nature for employer and employees alike. As well as allowing staff to give up part of their salary in exchange for tax-free benefits, companies have also been liable to pay lower National Insurance contributions on reduced employee wages – a situation viewed by many as win-win. For the basic-rate taxpayer sacrificing £100 of their salary, tax perks have allowed them to receive £100 in benefits for a salary deduction of just £68.

However, following what HMRC described as a "proliferation of luxury schemes" at a high cost to the treasury, 2016's Autumn Statement brought the controversial news that the Government would be axing salary sacrifice tax perks on a range of employee benefits. Terming the difference between the tax paid on cash salary and benefits "unfair", Chancellor Phillip Hammond announced that from 2017 "employees who use these schemes will pay the same taxes as everyone else." Only a few politically-motivated benefits, such as pension contributions, childcare vouchers, ultra low-emission vehicles (ULEVs) and cycle-to-work schemes will be exempt from the charges.

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JAMES MONKS
FINANCE DIRECTOR AT
RAM TRACKING

What should employers do next?

With these sweeping changes to salary sacrifice schemes certain to prove unpopular with employees, who have come to view these benefits as part of their remuneration package, it is essential that employers adopt a proactive and innovative approach to mitigating tensions among staff. An important part of this involves clearly communicating to staff about the incoming changes, taking care to emphasise that these are government rather than company-driven.

With a loss of tax perks certain to hit staff in the pockets, companies will also need to give careful thought to strategies for retaining staff, who may seek alternative employment offering them a higher salary. It is important to remember that those likely to feel the impact of these changes the hardest, are those workers already struggling to make ends meet. Therefore, businesses should look to introducing alternative ways to offer staff financial perks, such as a group benefits platform which allows employees to make savings across a range of everyday purchases. Alternatively, businesses could offer non-cash incentives – by implementing perks such as flexible hours and additional holidays, employers can help counteract any discontent resulting from tax changes by boosting overall employee wellbeing.

It is important to note that the changes announced in the Autumn Statement do not constitute a ban on salary sacrifice schemes, and employers can technically continue to offer these benefits to staff. However, in practice, the removal of tax perks on the majority of benefits makes them much less attractive to businesses and employers. The fact that the implementation of these changes coincides with the introduction of the apprenticeship levy only serves to increase the burden on organisations.

What are the key dates that employers need to be aware of?

Employers looking at introducing salary sacrifice schemes should bear in mind that they have a 12 month window before tax changes come in, as long as these are put in place by April 2017. With this in mind, companies should not delay in holding discussions with employees to see whether they are actually interested in receiving these incentives – if not, it is almost certainly not worth the effort of setting up. Those planning to go ahead should notify the revenue in plenty of time in order to avoid missing the April deadline and incurring costs early.

Key Dates	Activity
April 5th 2017	Must have a salary sacrifice scheme in place to receive tax-saving benefit*.
April 6th 2017	If a salary sacrifice scheme is set up on or after this date, it will not receive a tax-saving benefit*.
April 2018	Tax savings on most salary sacrifice schemes will end (if set up on or before 5th April 2017)*†.
April 2021	All tax-saving benefits will end on salary sacrifice schemes*.

** This does not include pensions, childcare vouchers, cycle-to-work schemes and ultra low-emission vehicles.*
† This does not include company cars, accommodation and school fees.

The incoming changes to salary sacrifice schemes will inevitably have an adverse effect on both companies and employees, with many areas of business feeling that the Government should instead be doing more to get people into work by maximising their disposable income. However, by taking the time to think carefully and innovatively about how to mitigate their impact on employees, companies can reduce disruption to business processes whilst maximising retention and productivity.

Salary sacrifice: A HR perspective

Why communication will be key for HRs

Samantha Fearnley, head of people at restaurant group Red's True Barbecue, explains what steps HRs need to take to boost employee morale.

In today's current economic climate where belts are being tightened due to Brexit uncertainty and many industries haven't raised wages, the Chancellor's decision to scrap most salary sacrifice schemes will come as a blow to SME owners and employees. Many employers have been using this initiative to cut down National Insurance Contributions (NICs) costs, whilst also passing tax savings to their staff, and so this disappointing decision by the Government could see both parties lose out.

For HRs – who would have used salary sacrifice schemes as a way of recruiting and retaining top talent – the challenge will be communicating these changes to the organisation, ensuring it doesn't disrupt employee morale and engagement levels. By being aware of key timings however, as well as talking to staff and offering alternative benefits if appropriate, HR professionals can safeguard against any potential backlash from workers to help keep them happy.

Communication

The first – and possibly most crucial – task that HRs will need to carry out is communicating with the team. It will be critical to explain why salary sacrifice changes are happening and how they are going to affect pay packets.

- Be informative and transparent
  HRs need to be honest with employees and inform them which salary sacrifice schemes are being axed, which ones are remaining and the key dates to be aware of, in a bid to minimise any potential confusion. It would be best practice to communicate this in writing, whether it be through a newsletter or company-wide email, as it will ensure that all staff receive the notice, giving them time to consider the changes and think of any questions. Ideally, this will be done electronically as it offers a level of track ability and can notify management is anyone has not received or acknowledged the communication. Prior to this, HRs should brief line managers so that when the written notice is issued, they will be able to deal with any immediate queries from their teams.

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SAMANTHA FEARNLEY
HEAD OF PEOPLE AT
RED'S TRUE BARBECUE

- **Get personal**
  Whilst it's essential that employees have an overview of the changes that will be taking place, ultimately, the question they will want answering is 'how is this going to affect my pay packet'. Therefore, it is advisable to set up one-to-ones with individuals, to give them a personal insight into how the changes will affect their take-home pay. HRs will need to speak to the payroll team beforehand, to make sure they have all the facts, figures and information ready for each employee.

- **Open a two-way conversation**
  Communication shouldn't be a one-way process; it should be an open dialogue. It may take time for some employees to digest the changes so it is important to have a dedicated member, or members, of staff that can be contacted at any point with questions. Employees should be clearly told of who these contacts are, and the best way to get in touch, to ensure that their concerns are being considered.

Alternative benefits package

If your business uses a salary sacrifice scheme that is about to be scrapped, such as gym membership or mobile phones, employees may expect or seek a replacement benefit to fill the gap. For HRs, offering an alternative may be a worthwhile investment, especially as benefit packages can play a key role in employee motivation and retention strategies.

Before looking at possible substitute benefits, it is vital that HRs consider the demographic and needs of their employees. To find out what perks employees would like, HRs could host workshops or create a survey to gauge a better understanding of their interests – after all, a perk is only valuable and has a benefit to the business if it is something that staff actually want and will use. However, when discussing potential perks to workers, it is essential that HR professionals be realistic about costs. A business will have a limited pot of finance to put into a benefits package and so expectations should be managed immediately.

Whilst it's essential that any perks benefit the worker, it's also important to not forget how the perk will be an advantage to the business. Therefore, this should also be a top consideration for HRs when looking for alternative schemes. For example, benefits that are awarded to teams that exceed performance or to individuals that try a new challenge could motivate and inspire, whilst perks that are not admin heavy can be implemented effectively.

Although HRs will do all they can to meet the needs of the employee and the business, it is important to remember that there is no one-size-fit-all solution and that not every worker can be pleased. Instead, HRs should listen and engage with staff, as well as shop around for the best corporate benefit schemes, to ensure that changes to salary sacrifice schemes are dealt with as seamlessly as possible.

Navigating the legal minefield of salary sacrifice schemes

Jodie Hill, solicitor at Milners Law, discusses the possible legal grey areas that may appear once some sacrifice schemes are scrapped.

Salary sacrifice schemes offer employers and employees a legal opportunity to reduce the amount of income tax and national insurance paid on a salary. It works by both parties agreeing to change their contractual terms and conditions, which then allows the employee to reduce their salary in exchange for a non-cash benefit.

With the Government planning on axing many existing salary sacrifice schemes, confusions may arise over what the employer and employee is legally entitled to do and/or have as of April 2017. For those employees that are already enrolled on a salary sacrifice scheme – a scheme that will be explicitly agreed to in their contract – questions may arise over whether there will be a fundamental breach of contract once it is scrapped or if workers can legally demand a pay rise considering they will be losing out financially.

For SMEs, this could prove to be a legal minefield. However, by carefully considering the questions employees may have, business leaders can be better equipped in informing staff of their rights to help mitigate against any potential backlash.

Can an employer legally remove a soon-to-be-axed salary sacrifice scheme?

As this is a change that is being imposed by the Government and not by the business, employers are in their legal right to remove salary sacrifice schemes. Even if an employee has a contractual entitlement to their current scheme, removing it will not be a fundamental breach of contract as it is keeping in line with the Government's agenda.

Those schemes that will soon be scrapped, such as school fees, accommodation and health screening checks, will remain tax-free until April 2018 to allow for sufficient time to phase them out. Therefore, it would be best practice to keep them until their benefits are axed, to safeguard against any possible tensions from employees.

Can an employee take legal action if their salary sacrifice scheme is scrapped?

As the employer is taking instruction from the Government as opposed to a personal decision, employees won't be able to take court action against the business. Instead, what employers might experience is an increase in the number of staff raising a grievance – an act that will be completely in their right – as they may have concerns or complaints over the new terms and conditions of their contract.

> " Employers should ensure they have the necessary procedures and practices in place to resolve grievances efficiently and fairly "

JODIE HILL
SOLICITOR AT
MILNERS LAW

To keep morale high amongst employees, employers should ensure they have the necessary procedures and practices in place to resolve grievances efficiently and fairly. Whilst in this instance it is very unlikely that any grievance will lead to an employment tribunal, failure to deal with the situation in an empathetic but effective manner could leave employees feeling dissatisfied and underappreciated at work, not to mention causing a huge strain on resources for a small business.

To make the process time-effective and as simple as possible for both staff and management, employers should ensure their grievance procedure is in writing and easily accessible. If a worker does raise a concern, management should at first try to resolve it informally. In cases where that does not work though, a formal meeting should be set up to allow employers to explain the changes and how it will personally affect the individual. By demonstrating that the business is willing to listen to staff's issues in relation to scrapped salary sacrifice schemes – as well as come to potential compromises – staff will feel more valued, strengthening their loyalty to the firm.

Can an employee legally demand a pay rise if the removal of a scheme significantly affects their pay packet?

Although employees may feel that they are financially missing out, employers are not legally obliged to offer pay rises to compensate the difference. In this instance, it is imperative that business leaders consult with their staff to ensure they are fully aware of how the changes will personally affect their pay packet.

By opening up a communication with employees, management may discover alternative solutions to compensate workers for losing out on salary sacrifice schemes. Non-cash initiatives, such as flexible working or early finishes, could be a substitute which doesn't have huge cost implications for a business but still offers a perk to their workers.

Whilst businesses do not have a huge legal responsibility in regards to scrapped salary schemes, it is essential that the issue is approached sensitively so that staff feel respected. Ensuring that relevant procedures are in place, as well as having open and honest conversations, business leaders can be confident that they are doing all they can to retain top talent during this potentially difficult period, ensuring they remain competitive in their market.

Salary sacrifice: A tax perspective

How to grow benefit packages despite tax changes

Craig Hughes, a private client tax director at Menzies LLP, suggests a two-tier approach to staff perks could be an ideal solution to employers and employees.

Offering tax relief on already popular benefits such as company cars, childcare vouchers and gym memberships, it is no surprise that salary sacrifice schemes have become so widely used by employers and employees alike. As well as allowing working people to purchase services they already use in a tax-efficient way, leaving them up to 47 per cent extra in their pocket, companies have had the advantage of paying reduced amounts of National Insurance on workplace perks offered to staff. However, the significant changes to salary sacrifice schemes announced in the 2016 Autumn Statement will make it unfeasible for employers to continue offering salary sacrifice schemes in the same way that they have done in the past. With this in mind, companies should plan carefully and well ahead of the April 2017 implementation date to ensure a smooth transition into the new system and avoid any potential disruption to operations.

How will the changes impact SMEs?

The removal of tax perks on the majority of employee benefits will have an impact on companies of all sizes and was not intended to specifically target a certain type of organisation. However, the added financial and administrative burden that these changes will inevitably impose is certain to have a greater effect on SMEs. While larger organisations often enjoy a reasonable amount of financial flexibility, the budgets of small firms are often strictly controlled. Such restriction can make it more challenging for them to fund changes facilitating their workforce's transition to the new model of salary sacrifice schemes. Additionally, where many large companies have specialist software and in-house teams of finance and HR experts to help them assess staff benefits on an employee-by-employee basis, SMEs will potentially have to pay to seek this advice from a third party.

The incoming changes to salary sacrifice schemes are also likely to have a particular impact on SMEs in terms of their ability to compete within the UK jobs market. While lacking the brand and reputation of larger organisations, benefits packages are often used by smaller companies to attract and retain quality job candidates. In order to prevent the changes to salary sacrifice schemes having a negative impact on employee turnover, companies lacking the financial flexibility to 'top up' workforce benefits should think innovatively about alternative ways to introduce flexibility into perks offered to staff. For example, with modern technology now making it possible for staff to work and communicate with colleagues wherever they are, the option to work from home is a non-financial benefit which can provide a valuable increase to employee engagement and wellbeing. Benefits such as flexible hours and additional holidays provide other ways that firms can increase the value of their overall remuneration package in order to boost employee recruitment and retention drives.

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CRAIG HUGHES
PRIVATE CLIENT TAX DIRECTOR AT
MENZIES LLP

What do employers need to consider?

The popularity of salary sacrifice schemes amongst staff makes it essential for companies to prioritise the communication of the changes to employees in order to minimise any potential tensions that may arise. One of the key points to emphasise when addressing staff is that the revisions due to be implemented in April are government driven rather than company-led. The scale of the changes will also require employees to be fully aware of what impact there is likely to be on their individual financial situations and make informed and timely decisions accordingly. As such, firms may wish to consider ensuring their workforce is clear about what the removal of certain tax perks means for them by bringing in a specialist to present a seminar on the topic.

Adopting a two-tier approach

With the majority of employers simply unable to absorb the costs attached to existing salary sacrifice schemes, it may at first seem an obvious solution to simply remove employee benefits altogether in order to reduce those which remain tax-free. However, the continued demand for benefits, such as mobile phones and gym memberships, as well as the restrictions imposed by individuals' contractual obligations, are likely to make this impractical. As such, adopting a two-tier approach, whereby employees can continue to use benefits which are 'free' to use, such as childcare vouchers, alongside those incurring a tax liability can be a logical solution.

What is a two-tier approach?

A two-tier approach is an opportunity for employers to get creative when it comes to offering staff perks. With a two-tier scheme, employers will be able separate those perks that will still receive a tax-saving, such as childcare vouchers and pensions, from those that will lose their tax-free status, such as gym membership, into 'tier-two perks'.

By doing this, the employer is making it very clear to its workers which benefits will be tax-free and which ones won't. With tier-two perks, employers will have to consider how to fund these, whether it will involve setting up direct discounts with local businesses or via a discount platform, such as Perkbox.

With significant costs and additional administration likely to be involved in implementing one of these new systems though, SMEs should carefully consider their suitability for the business as well as available resources to avoid landing themselves in financial difficulty.

While staff are unlikely to react positively to news of the changes to salary sacrifice schemes, careful and timely planning by employers can play a significant role in minimising any upset and helping to keep day-to-day business processes running smoothly. By investing time in clearly communicating new policy to employees and thinking of new and creative ways to enhance the workforce benefits package, SMEs can navigate changes smoothly and continue to compete in the UK jobs market.

Who to contact

To speak to our expert contributors, contact Daniel Bell at RAM Tracking.

Telephone: 0330 100 3622

Email: danielb@ramtracking.com