



Low Incomes
Tax Reform
Group

A voice for the unrepresented

**Salary sacrifice for the provision of benefits in kind
HM Revenue & Customs (HMRC) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 LITRG welcomes the opportunity to respond to this consultation, concerning proposed limitations to the range of benefits in kind (BIKs) that attract income tax and/or National Insurance contributions (NIC) advantages when provided as part of salary sacrifice arrangements.
- 1.2 We commend HMRC for holding roundtables with interested parties to discuss these issues. This is an important topic and it was clear from the meeting we attended that it is also an emotive one. We sincerely hope that the deadline of 19 October with an announcement expected at the Autumn Statement (little over four weeks later) will give HMRC sufficient time to consider fully all of the points made by stakeholders, whether made at those meetings or in writing.
- 1.3 In our view, and particularly in the current economic climate, it is understandable that some employers and employees would want to enter into a salary sacrifice arrangement in exchange for other benefits. We therefore have strong reservations about the proposals.
- 1.4 We appreciate that there are concerns around the growth of salary sacrifice and the increasing cost to the Exchequer. However we understand anecdotally that much of this is coming from the public sector. Does HMRC's evidence back this up?
- 1.5 This is an important point because, if this is indeed the case, it seems to us that those using salary sacrifice are just as likely to be NHS nurses on modest salaries making small savings by sacrificing salary into a workplace parking scheme as, for example, higher paid senior staff sacrificing salary into several schemes to stay below the personal allowance threshold.
- 1.6 To remove the tax and NICs advantages from all 'new' BIKs supplied through salary sacrifice schemes on a blanket basis will damage arrangements used by lower income workers – in terms of affecting both the motivation and financial position of employees who may already be struggling, and also the ability of their employers to recruit and retain key staff.

- 1.7 If employers' reaction to the proposed changes is to revert to just paying cash (commercially speaking we would have thought this a more likely scenario than them continuing to try to arrange salary-sacrificed benefits), then there could be a knock-on effect to some employees' tax credits – not only in terms of them having to grapple with the complex disregard rules but also in terms of them ultimately facing a reduced award due to their higher cash income.
- 1.8 We therefore cannot agree with the proposals as they stand due to the potential impact on low income workers, and suggest that if HMRC want to make some savings in this area then they should consult instead on the possibility of a more targeted course of action, for example by limiting tax reliefs to a certain amount as is the case for childcare vouchers.
- 1.9 We can agree, however, that salary sacrifice arrangements mean that the playing field is not level for all and we are thinking especially of those who are paid at or near the minimum wage who would not be able to participate, whereas those with slightly higher wages may be benefiting. In our view, the 'risks' to such employees of using salary sacrifice are largely overstated. We would therefore strongly urge the government to consider possible options for providing some relief to these employees, as this would help to make the 'fairness argument' for making changes more coherent.
- 1.10 Should the government press ahead with these proposals, it is vital that the legislation is drafted carefully. We are particularly concerned about arrangements where an employee can choose between taking living accommodation offered by their employer or getting a higher cash wage and arranging your own living accommodation as are found among low paid farm workers and care workers. We assume it is not, and indeed strongly suggest that it should not be, HMRC's intention to catch such arrangements. If the changes therefore do go ahead, the legislation must be drafted such that they are not included (difficult though this may be to define).

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

- 3.1 LITRG welcomes the opportunity to respond to this consultation.
- 3.2 While we commend HMRC for holding roundtables with interested parties to discuss the proposals, we are disappointed that the period given for written responses falls two weeks short of the customary 12 weeks usually allocated to consultations on important changes. This is particularly considering the number of other critical HMRC consultations currently in circulation and potentially demanding stakeholder attention.
- 3.3 If the proposals are to be taken forward, as much further opportunity as possible should be given for comment on draft Finance Bill clauses, together with Parliamentary scrutiny during the Finance Bill process. Indeed, it should be drawn to Parliament's attention that the number and quality of responses might have been affected due to the conflicting demands on stakeholders' time resulting in prioritisation of those consultation documents to which they should devote attention.
- 3.4 We trust that HMRC will take on board the strength of feeling from representatives in the meetings and give due weight to the points made, particularly if all attendees have not also put their views in writing.
- 3.5 Furthermore, a deadline of 19 October 2016 with 'an announcement at Autumn Statement 2016 on decision made in light of those responses'¹ raises concerns as to whether HMRC will have sufficient time to digest the responses and fully consider all of the issues before announcing an outcome. We hope that such concern is misplaced.

4 Impacts – general comments

- 4.1 Salary sacrifice schemes are mainly used to take advantage of the beneficial tax and NIC rules that exist where employers provide benefits. Many would say that those underlying rules are arbitrary and unfair – this is reflected in those employees who are fortunate enough to work for employers who offer tax and NIC free benefits being able to obtain an advantage, as against those that do not and have to pay for those same items themselves out of out of their net pay. Until very recently HMRC's own view seems to have been that salary sacrifice arrangements are not 'avoidance' and are actually a matter of employment law, not tax law.²
- 4.2 In these tough economic times, the concept of a remuneration package consisting of wages with benefits on top is outdated – HMRC seem to be failing to recognise this. This is particularly likely to be the case for public sector employers who, since the financial crisis, have had to be cost efficient and creative in terms of being able to attract and retain employees.
- 4.3 Taking these two things together, the growth in salary sacrifice is unsurprising.

¹ See page 2 of the consultation document under 'After the consultation':
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/549682/Salary_sacrifice_for_the_provision_of_benefits-in-kind_HMRC_consultation.pdf

² HMRC's guide, including information on how to make a salary sacrifice arrangement effective, can be found here: <https://www.gov.uk/guidance/salary-sacrifice-and-the-effects-on-pay>

- 4.4 While we appreciate that there are concerns around the growth of salary sacrifice and the increasing cost to the Exchequer, we would be interested to understand more about where the 'growth' in salary sacrifice schemes since 2009/10 is coming from. We understand anecdotally that it is indeed from the public sector. Does HMRC's data back this up? We are disappointed that a more granular breakdown of the results of HMRC's evidence-gathering during December 2015 and January 2016 has not been provided in the consultation document, as this could have helped to inform stakeholder responses.

5 Questions

- 5.1 ***Question 1: Alongside annual leave, are there any other salary sacrifice arrangements that the government should be made aware of that do not strictly involve receipt of a benefit?***

- 5.1.1 We have no comment to offer.

- 5.2 ***Question 2: What are the likely impacts on employers and employees of limiting the scope of BiKs that can obtain tax advantages when offered through salary sacrifice arrangements?***

- 5.2.1 If our understanding about the growth of salary sacrifice largely being from the public sector is correct, then the likely impacts on employers and employees of limiting the scope of BiKs that can obtain tax advantages when offered through salary sacrifice are significant.

- 5.2.2 We are concerned that HMRC's proposals to save money will just as likely be at the expense of NHS nurses on modest salaries, making small savings by sacrificing salary into a workplace parking scheme, as those employees who can perhaps better afford it.

- 5.2.3 Let us say that employee X on page 12 of the consultation document (who has sacrificed £600 of their £25,000 salary a year for workplace parking) is such a public sector worker. The small tax and NIC saving of £192, perhaps coupled with their employer's ability to negotiate a corporate discount on the parking charges, will be very welcome in terms of helping their pay go a little further each month – particularly if they have been battling with a long-term pay freeze.

- 5.2.4 If the employer's reaction to the proposed changes is to revert to paying that employee £25,000 cash (commercially speaking we would have thought this a more likely scenario than them continuing to try to arrange salary-sacrificed benefits with all the administrative hassle that goes with it), the employee will face a higher tax and NIC bill **and** potentially more expensive parking charges. Not only that, but if they are receiving tax credits, then there could be knock-on effects – both in terms of them having to grapple with the complex disregard rules and ultimately facing a reduced award due to their higher cash income.³

- 5.2.5 Further, the loss of the employer NIC saving of £82.80 (when extrapolated across their whole workforce) is also likely to make the employer's life very difficult. Already under pressure due to other reforms and efficiencies, the consequences on employers could be wide-reaching.

³ The disregard rules are explained here: <http://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/understanding-the-disregard/#Income rises>

5.3 ***Question 3: Are these impacts different, or are there different considerations, for large/small businesses or particular business sectors?***

5.3.1 See our answer to Question 2.

5.4 ***Question 4: Are the impacts different for particular BIKs?***

5.4.1 It is difficult to answer this question as this depends on the BIK in question and the facts and circumstances of the recipient.

5.4.2 To explain this further – while HMRC’s judgement appears to be that benefits other than pension saving, childcare and cycle to work, are non-essential (as implied in the consultation document), the availability of certain benefits to vulnerable workers could be vital. For example, we are thinking of gym membership⁴ on the health and wellbeing of an employee with mental health issues; or an otherwise unaffordable home computer for a low income family – particularly in the context of the government’s ‘digital by default’ agenda.

5.4.3 There is also an argument that some salary sacrifice-related benefits like gym membership are not just valuable to individuals but are valuable to society more generally too. They may result in reduced NHS costs, for example, if those taking them up are likely to be fitter and healthier. These wider considerations need to be taken into account in any impact assessment, rather than just looking at the Exchequer costs of salary sacrifice.

5.5 ***Question 5: Do you think that the government needs to take any steps to mitigate any negative consequences of this change for employees and employers, such as those who may be locked into salary sacrifice arrangements? If responding, it would be helpful to understand specific examples and factors the government should take into consideration.***

5.5.1 Clearly HMRC would need to offer some kind of transitional protection to help employees who are part way through, and cannot exit, a particular benefit contract.

5.5.2 However, perhaps a more pertinent question here would be ‘Do you think that the government need to take any *alternative* steps to mitigate any negative consequences for employees and employers...?’

5.5.3 The answer to such a question would be that HMRC should reconsider their broad brush proposals and take more targeted action instead. An alternative approach would be for HMRC to legislate more specifically for those BIKs that are causing them *most* concern as they have done previously for canteen facilities for example.⁵ Other options might be for instance to consult on limiting the number of sacrifices a person can make, or to limit the level of relief available according to the tax rate paid by the employee (as in the case of childcare vouchers).⁶ It would, of course, be understandable if HMRC wanted to keep the whole regime under review in the meantime.

⁴ In reality this is only costing the Exchequer the employees NIC, as this is otherwise a P11D/Class 1A benefit.

⁵ Finance Act 2010 amended section 317 of ITEPA to restrict the exemption for the benefit of free or subsidised meals where an employee has an entitlement in conjunction with salary sacrifice or flexible benefits arrangements to employer-provided free or subsidised meals.

⁶ A basic rate taxpayer can have up to £55 of childcare vouchers a week, a higher rate taxpayer £28 and an additional rate taxpayer £25 .

5.5.4 Moving forward in this way feels much more acceptable to us as it may help protect those taxpayers we are most concerned about. While we acknowledge that going down this route will still mean a partial cost to the Exchequer, this may be a price worth paying if, for example, the wider benefits to society are taken into account such as we describe in answer to question 4 above.

5.5.5 In the longer term, and with an eye on simplification, HMRC might want to consider undertaking a wholesale review of the problematic underlying rules that are the cause of the salary sacrifice phenomenon in the first place. Expanding on our point at 4.1 above, it would perhaps make more sense for HMRC to review tax-exempt benefits as a whole and consider, subject to consultation, whether they are still relevant and justifiable. If they are, then why deny access to them whether or that is by way of salary sacrifice or otherwise?

5.6 ***Question 6: Do you consider that the approach proposed for legislation would work as intended?***

5.6.1 It is hard to answer this question without seeing the draft legislation. But, should HMRC press ahead with these proposals, they must do so carefully and there are a number of potentially difficult areas that will need dealing with in the legislation.

5.6.2 For example, we understand that the proposals are intended to catch salary sacrifice, salary exchange and 'flexben' arrangements. However we are very concerned about situations where you can choose between taking living accommodation offered by your employer or getting a higher cash wage and arranging your own living accommodation. This type of arrangement is found, for example, in low paid industries such as agriculture and care work. We presume that these type of scenarios are not intended to be caught, but we can see no easy way to draft the legislation to stop them being included. Nonetheless, every effort should be made to exclude them.

5.7 ***Question 7: Are there any consequences the government has not considered in proposing to legislate in this way?***

5.7.1 An issue that should not be overlooked is that having some choice in how their remuneration 'budget' is spent can make employees feel valued and supported in both their work and personal lives. HMRC will essentially limit the ability for employers to incentivise their staff by pursuing their intended path and this risks disenfranchising swathes of the working population.

5.7.2 In addition, as the changes proposed are partly being made under the banner of 'fairness' we feel compelled to point out that those employees who work for an employer that offers an 'approved' salary sacrifice scheme will enjoy tax and NICs advantages over those employees for whom this is not the case – ie there will still be differential treatment between employees in otherwise comparable circumstances even after the proposed changes have taken place.

5.7.3 To really 'level the playing field' then and make this a more coherent change, is there an argument that HMRC need to do more to encourage *all* employers to offer 'approved' salary sacrifice schemes?

5.7.4 Furthermore, the consultation document (para 1.3) says 'where BIKs are offered only through salary sacrifice arrangements, employees with earnings at or near the National Minimum Wage or the National Living Wage cannot participate because salary sacrifice arrangements cannot reduce an employee's cash earnings below the National Minimum Wage or National Living Wage rates. Those

employees who are not able to participate in salary sacrifice arrangements are at a disadvantage. They have to fund what may otherwise be offered as a BIK from their net pay, whereas others can receive the BIK at a reduced cost at the expense of the Exchequer’.

- 5.7.5 We are pleased that the plight of the lowest paid members of society has been recognised, however are dismayed that the proposals then fail to address the problems they face.
- 5.7.6 One of the concerns about allowing the lowest earners to sacrifice salary has been the risk of their pay dropping below the point at which entitlement to contributory benefits is triggered (the Lower Earnings Limit (LEL)).⁷ In practice, this is becoming less and less likely to occur, given the fact that the minimum wage rates are rising much faster than the LEL. Even if earnings did drop below the LEL, National Insurance credits might be available to effectively restore entitlement.
- 5.7.7 Ideally, the National Minimum Wage Regulations would be rethought to allow those on the minimum wage to participate in salary sacrifice arrangements. Many lower earners (possibly female) are well able to afford to salary sacrifice taking into consideration their overall household income. With the correct information about the effects that a reduction in their pay might have on their entitlement to benefits and so on, they should be able to make their own sensible decision. Saying that, there would be nothing to stop the government building in a safeguard to stop salary sacrifice pushing an employee's salary below the LEL to ensure their contributions record remain protected.
- 5.7.8 Given such a change is unlikely to occur any time soon, we call on HMRC to consider whether there are any other ways of providing the lowest paid workers with some relief in the meantime – particularly with benefits like childcare vouchers which could be vital to them working or pension saving which many are now automatically enrolled into.⁸
- 5.8 ***Question 8: Would this timeline present employers with difficulty, for example with updating payroll software?***
- 5.8.1 We think 6 April 2017 is too close a date for implementation of the proposed changes and is unacceptable.
- 5.8.2 As we have demonstrated throughout this response, the impacts of these changes are potentially wide ranging. We therefore think that it would be better to consider other options, but if HMRC do press ahead with the proposals, they need to provide as long a lead time as possible during which employers and employees alike can prepare for the changes and wind down existing arrangements.
- 5.8.3 A generous period will also allow employees within the salary sacrifice industry, who will no doubt face redundancy as a result of these changes, time to consider their options.
- 5.9 ***Question 9: Are there any other changes that employers would need to make?***
- 5.9.1 See our answer to question 8.

⁷ In 2016/17 this is £112 per week.

⁸ There is already an issue with low paid workers and auto-enrolment. Workers are automatically enrolled at £10,000, yet only become taxpayers at £11,600 (in 2016/17). Only ‘relief at source’ models offer non-taxpayers tax relief on their contributions, however some pension schemes use net pay arrangements. Under these schemes the lowest paid workers receive no tax relief on their pension contributions.

5.10 Question 10: Are there any other compliance considerations which HMRC should be aware of?

- 5.10.1 Notwithstanding the difficulties we think HMRC will encounter in ‘catching’ agreements around salary/benefits made informally as part of contract negotiations, we think HMRC need to be aware that unless these new rules are watertight and are backed up by adequate enforcement action then there is a risk that some employers may find ways around them and continue to offer salary sacrifice-related benefits.
- 5.10.2 We are seeing something like this in relation to low paid agency workers whose umbrella company employers are continuing to reimburse mileage expenses on a salary-sacrificed basis despite s289A ITEPA 2003⁹ which allows for an exemption for paid or reimbursed expenses but specifically excludes expenses which are paid via a salary sacrifice arrangement.
- 5.10.3 With apparently little fear of HMRC compliance action, some umbrella company employers are ‘testing’ the definition of ‘relevant salary sacrifice arrangements’¹⁰ in s289A ITEPA 2003 and are continuing to offer reimbursed expenses outside of mileage – by way of a ‘fixed pot model’ whereby money is estimated for expenses, put aside and drawn when the expense is incurred (ie not strictly via salary sacrifice).¹¹ We would have thought that this is against the spirit of the law, if not the actual letter and so will be dealt with by further legislation in due course. Such situations cause confusion and uncertainty all round, so we recommend that HMRC avoid the same problems here by taking time to get the details right.

LITRG

17 October 2016

⁹ Inserted by s11 Finance Act 2015 <http://www.legislation.gov.uk/ukpga/2015/11/section/11/enacted>

¹⁰ Per sub section 5: ‘ “Relevant salary sacrifice arrangements”, in relation to an employee to whom an amount is paid or reimbursed in respect of expenses, means arrangements (whenever made, whether before or after the employment began) under which—

(a) the employee gives up the right to receive an amount of general earnings or specific employment income in return for the payment or reimbursement, or

(b) the amount of other general earnings or specific employment income received by the employee depends on the amount of the payment or reimbursement.’

¹¹ The fixed pot model is explained further here: <http://blog.libertybishop.co.uk/hook-line-and-tax-debt/>