Effective salary sacrifice arrangements

A salary sacrifice arrangement is one where an employee gives up some of his or her cash salary in return for a non-cash benefit. Salary sacrifice arrangements used to be a popular way to take advantage of tax and National Insurance exemptions for benefits in kind. However, new valuation rules were introduced from 6 April 2018, removing most of the benefits for all but a handful of benefits in kind.

So, where a salary sacrifice arrangement remains tax-effective, what steps should be taken to ensure the arrangement is acceptable to HMRC?

Which benefits?

Post 5 April 2017, where provision is made via a salary sacrifice arrangement, the tax and National Insurance exemptions associated with the following remain available:

- payments into pension schemes;
- employer-provided pension advice;
- childcare vouchers, workplace nurseries and directly contracted employer-provided childcare; and
- bicycles and cycling safety equipment, including cycle to work schemes.

For all other benefits, with the exception of low-emission cars, the benefit is now valued at the higher of the salary foregone or cash alternative offered and the normal cash equivalent value (which will be zero where the benefit would otherwise be exempt). Transitional rules delay the start date of the new valuation rules for arrangements in place at 5 April 2017.

Entering into a salary sacrifice for benefits not on the above list can still generate savings as the NIC liability will move from Class 1 to Class 1A, saving employee's NIC. However, these may not be sufficient to justify the administration costs involved.

Keeping it effective

For HMRC to accept that a salary sacrifice arrangement is effective, the employee's contract must be varied to show the lower salary and the benefit in kind taken in exchange. The employee must not simply be able to revert back to the higher salary at will – if this is the case, HMRC will disregard the salary sacrifice arrangement and tax employee by reference to the higher salary, losing the benefit of any exemption attaching to the benefit in kind. If the employee wants to opt out of the salary sacrifice, again, the terms of his or her contract should be changed to reflect the revised arrangement.

Further, the actual arrangements must mirror the contractual position so that the employee actually receives the lower salary and the benefit in kind.

Timing is important. The contract must be varied to reflect the salary sacrifice before the changes come into effect – if the contract is not varied until after the changes have been implemented, the employee will be taxable on the higher salary (even though he has not received it), as he remains contractually entitled to do so.

Still useful

Although the benefits of salary sacrifice arrangements are much reduced, they still have a role to play – but where used it is important that they are effective in HMRC's eyes.