

Rewarding staff suggestions in a tax-free manner

Many organisations operate a staff suggestion scheme and reward employees where a suggestion is adopted which will benefit the organisation or save money. The tax system contains an exemption which allows suggestion scheme awards to be made tax-free – but only up to a certain limit and only as long as the associated conditions are met.

Types of award

The tax exemption recognises two types of award:

- Encouragement awards;
- Financial benefit awards.

Encouragement awards

An encouragement award is an award other than a financial benefit award which is made for a suggestion with intrinsic merit or showing special effort.

Financial benefit awards

A financial benefit award is an award for a suggestion relating to an improvement in efficiency or effectiveness which the employer has decided to adopt and reasonably expects will result in financial benefits.

Conditions

The tax exemption applies where an employer establishes a scheme for the making of suggestions which is open on the same terms to employees of the employer generally or to a particular description of them, for example all employees at a particular site or a particular department.

The following conditions must also be met:

- the suggestion relates to activities carried on by the employer,
- the suggestion is made by an employee who could not reasonably be expected to make it in the course of the duties of employment, taking into account the employee's experience; and
- the suggestion is not made at a meeting which is held for the purpose of proposing suggestions.

Tax-free limit for encouragement awards

Tax-free encouragement awards are capped at £25.

Tax-free limit for financial benefit awards

Working out the tax-free limit for a financial benefit award is slightly more complicated. The limit depends on the savings that the suggestion is expected to yield and the number of awards that are made.

The starting point is the suggestion maximum which is the financial benefit share or, if less, £5,000.

The financial benefit share is the greater of:

- 50% of the financial benefit that could reasonably be expected to result from the adoption of the benefit for the first year after its adoption; and
- 10% of the financial benefit that could reasonably be expected to result from its adoption in the first five years after its adoption.

If no award has been made for the suggestion before, the tax-free limit is the suggestion maximum where one award is made or the appropriate proportion of the suggestion maximum if two awards are made on the same occasion to different people (for example 25% if an award is made at the same time to four people).

In the event that further awards are made for the same suggestion, the tax-free limit is the remainder of the suggestion maximum if one such further award is made, or an appropriate proportion of the remainder of the suggestion maximum if two or more further awards are made.

Example

Two employees suggest replacing disposable cups with reusable cups. The suggestion will save £8,000 in year 1, and £10,000 a year thereafter.

The financial benefit share is the greater of:

- £4,000 (50% of £8,000); and
- £4,800 (10% of £48,000 (savings in years 1 to 5 being £8,000, £10,000, £10,000, £10,000 and £10,000)),

i.e. £4,800.

As this is less than £5,000, the suggestion maximum is £4,800.

The maximum tax-free award that can be made to each employee is £2,400 (50% of £4,800).

Partner note: ITEPA 2003, s. 321.