



# ABOUT THE PMI

## THE PENSIONS MANAGEMENT INSTITUTE (PMI)

Founded in 1976, the Pensions Management Institute (PMI) is the UK's largest and most recognisable professional body for employee benefit and retirement savings professionals, supporting over 6,500 members in 32 countries.

PMI's members, represented in 9 regions, are responsible for managing and advising some of the largest institutions in the world accounting for £1 trillion invested in pensions. We promote excellence through a range of services for the benefit of members, the wider economy and with over six million now saving as a result of automatic enrolment, society as a whole.

The purpose of the Institute is "To set and promote standards of excellence and lifelong learning for employee benefits and retirement savings professionals and trustees through qualifications, membership and ongoing support services".

To achieve this, PMI:

- Promotes and embeds professional standards, setting the benchmarks for best practice
- Produces qualifications that have a reputation for excellence and ensure that employee benefits and retirement savings professionals, whether they are scheme managers, consultants, administrators or trustees, are educated to the very highest standards and the latest legislation
- Provides continued lifelong learning designed to strengthen the knowledge and skills of employee benefit and retirement savings practitioners in performing to the best of their ability
- Plays a pivotal role shaping the industry, working with Government and collaborating with other bodies on research and thought leadership on key issues
- Presents an annual conference and a wide range of technical seminars from entry-level to those for highly experienced professionals
- Provides industry-leading insight, including Pensions Aspects, PMI TV, Expert Partner insights, newsletters and blogs to keep practitioners abreast of the very latest developments in a rapidly-changing industry
- Proactively has a voice in mainstream and social media with a presence on Twitter and LinkedIn  
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We specialise in advising on, and managing, defined benefit and defined contribution pension schemes (including the provision of the services of a Scheme Actuary) in the United Kingdom and Ireland and acts as a provider of administration services to employers, trustees, pension plan members and professional advisers.

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For more information visit [www.spenceandpartners.co.uk](http://www.spenceandpartners.co.uk)

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# FOREWORD

PMI was formed in 1976 to promote professionalism amongst those working in the field of pensions. Today, we are acknowledged as the institute for pensions professionals. We have developed study and examination facilities leading to a nationally recognised qualification – the Advanced Diploma in Retirement Provision. This embraces all aspects of law and practice relating to the management of workplace pension arrangements.

The Advanced Diploma is a comprehensive and in-depth qualification for retirement benefit professionals. It is the qualification component for Associateship (APMI) of the Pensions Management Institute (PMI).

The structure of the Advanced Diploma was comprehensively revised for first examination in 2016. This revision was to ensure that the syllabuses were up to date and the qualification continues to meet the needs of users. The Advanced Diploma framework comprises five core units and five specialist units. To complete the Advanced Diploma students will need to complete eight units as set out below.

The foundation of the qualification is formed of four core units. These compulsory units cover all aspects of retirement provision in the UK, including regulation, administration, financing and investment. There is an additional option covering international employee benefits. The core units are assessed by a two hour examination. The core units are then followed by specialist units. Students choose either, or both, of the Tier 1 specialist units - Defined Benefit Arrangements or Defined Contribution Arrangements as most appropriate for them. Depending whether both or just one of the Tier 1 specialist units are selected either one or two further specialist units can be selected from the Tier 2 specialist options including Reward, or International Employee Benefits. These choices allow the students to select those areas that best fit their current work or future career aspirations. Finally the Professionalism and Governance Unit must be completed by all Students. All of the specialist units are assessed by 3 hour written examinations.

There are several Diploma level qualifications comprised of units from within the structure of the Advanced Diploma for those who do not want or need to complete the Advanced Diploma. These have also been revised as part of the changes to the Advanced Diploma.

The Diploma in Retirement Provision (DRP) includes all four UK focussed core units and either of the Tier 1 specialist units (Defined Benefit Arrangements or Defined Contribution Arrangements). The DRP would be completed by all those who proceed to complete the Advanced Diploma.

The Diploma in Employee Benefits and Retirement Savings (DEBRS) is ideal for those who need to understand pensions in the wider savings and employee benefits context, and consists of two of the core units and the Tier 2 specialist Reward unit.

The Diploma in International Employee Benefits (DipIEB) consists of the two internationally focussed units: the Foundation in International Employee Benefits core unit and the Tier 2 specialist unit - Managing International Employee Benefits. These units have been developed in partnership between PMI and the International Employee Benefits Association.

Those who wish to complete the Advanced Diploma can opt to take the units that comprise the DRP, DEBRS and/or DipIEB on the way to becoming Associate Members of PMI. Alternatively, those who only wish to sit those Diplomas can become Professional members of PMI on completion.

## Reward and Retirement Provision

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There are many benefits to be gained from studying for, and attaining, these qualifications. These include the body of knowledge and understanding gained and its application to practical situations, a demonstrated commitment to learning and development, and enhanced status, confidence and opportunities for career progression.

Undertaking this rigorous professional qualification places demands on students and we are committed to supporting studies with quality learning provision. Under the banner “Shaping the pensions professionals of tomorrow” we are delighted to be working with some of the UK’s leading companies and firms within the pensions industry who have taken on the role of study support partners. In each unit the study material comprises a study manual and access to a web-based distance-learning course designed to prepare students for the examinations.

Professionalism and Governance seeks to provide an understanding of the importance of professionalism, ethics and continuing their own professional development and to provide an appreciation of risk and governance issues as they apply to pension schemes, and to enable candidates to demonstrate their ability to apply risk and governance principles in a practical situation and that they can communicate their knowledge in a way that is relevant to their audience. The 2024 version of the study manual reflects the Pensions Regulator’s focus on 21st Century Trusteeship and increased focus on environmental, social and governance issues together with updates and guidance from industry standard setting bodies in administration, accounting and governance.

Further details on the other units that comprise the Advanced Diploma and the work of the PMI can be found on the website. We hope you will enjoy studying for the Advanced Diploma. We welcome feedback and this should be directed to the Qualifications Department at PMI:

**[pmiqualifications@pensions-pmi.org.uk](mailto:pmiqualifications@pensions-pmi.org.uk)**

### PMI PATHWAYS

It is an exciting time at the PMI, as we launched our new pathways in April 2023, to make our Membership and qualifications easier to access for all. PMI Pathways is curated as a combination of full qualifications and some of our core units from the Advanced Diploma in Retirement Provision, representing five specialisations: Retirement Provision, Pensions Administration (Technical or Practical), Pensions Trusteeship and Pensions Benefits.

Under the new Pathways, all learners will start their journey with the PMI as a student member. Successful completion of a full qualification\* will give you eligibility for Professional membership status. A learner can then progress to Associateship after completing all exams listed under the pathway and holding Professional Membership for two straight years.

After 5 years of continuous Associate Membership with CPD and demonstrable experience, you can then apply to become a Fellow.

Please note Professional Membership is mandatory for two years for anyone who wants to apply for an Associate Membership. This will be in addition to completing all the relevant qualifications and combination of units under their chosen pathway.

For further details regarding the pathways, please visit our website page here:

**<https://www.pensions-pmi.org.uk/pmi-pathways/>**

\* Full qualification or five Advanced Diploma in Retirement Provision modules listed under the named Pathways.

# PREFACE

This unit aims to highlight and explain some of the other elements that can make up an employment package. It covers a number of different elements that may make up an employment or total remuneration package. Please note that this is not an exhaustive list and other benefits may also be included.

So what is total remuneration? The University of Washington defines total remuneration as “the sum of the financial and non-financial value to the employee of all the elements in the employment package ... and any other intrinsic or extrinsic rewards of the employment exchange that the employee values”.

As outlined in the definition, an individual’s employment package is not just made up of his or her salary. It could also include incentives, pension, healthcare, holiday, life assurance, perquisites, job satisfaction, organisational affiliation, status and so on. The term total remuneration is used for all these benefits as most of these have a monetary value to the member, for example life assurance or healthcare benefits, and therefore form part of the remuneration for employment.

Part 1 of the manual covers how an employee benefits strategy is developed and communicated. Some of the benefits which may be included such as healthcare are covered in Part 2. The delivery of employee benefits is also important. In Part 3 Company Share Plans, Flexible Benefits and Salary and Bonus Sacrifice are discussed including the tax implications and the effect on a pension scheme.

There is more to an employment package than just salary and pension. Applicants would generally look at the overall package being offered, if that is not competitive with the rest of the industry acceptance of employment offers may be affected as well as staff retention. the rest of the industry acceptance of employment offers may be affected as well as staff retention.

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# SYLLABUS

### **Aim:**

To provide an understanding of the main employee benefits, their value, cost structures, taxation implications and how they interact with saving for retirement. To include appreciation of:

- the employee and employer perspectives
- rewards strategies
- communication and engagement

1. **outline** the factors to be taken into consideration when developing a total rewards strategy

**explain** the impact of the following:

- *employee demographics*
- *globalisation*
- *possible impact of BREXIT*
- *cost*
- *market position*
- *recruitment and retention*
- *automatic enrolment*
- *employee and employer perspective*
- *flexible benefits*
- *State benefits*
- *communication of employee benefits:*
  - *methods*
  - *advantages and disadvantages*
  - *employee behaviour*
  - *the Pensions Regulator's guidance*
  - *roles and their interaction*
  - *HR, payroll, pensions, finance*
  - *data flows*
  - *selecting and managing providers and advisers*

2. **demonstrate an understanding** of the employer perspective in relation to a total rewards strategy including oversight responsibility

**explain** the development of rewards strategies including the needs of an ageing population

**outline** the tax implications and the pensions benefit implications

3. **outline** the elements that employers may use as part of their rewards package

**analyse** each of the following:

- *income protection schemes*
- *critical illness schemes*
- *health care schemes*
- *personal accident benefits*
- *sabbaticals*
- *career breaks*
- *child care*
- *dental/optical cover*
- *retail vouchers*
- *other elements*

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4. **explain** the main features of establishing and maintaining the rewards package  
**explain** the impact of the following:
  - *employee engagement and communication*
  - *broking benefits*
  - *timing*
  - *benefit evaluation*
  
5. **explain** the purpose and principal features of company share schemes  
**analyse** each of the following:
  - *SAYE share option schemes*
  - *Share Incentive Plans*
  - *executive share option schemes*
  - *profit sharing schemes*
  - *employee share ownership plans*
  - *unapproved and phantom share schemes*
  - *tax treatment*
  - *capital gains tax*
  - *an overseas sponsor*
  
6. **explain** the concept of remuneration as part of a rewards package  
**analyse** each of the following:
  - *remuneration*
  - *bonus schemes*
  
7. **demonstrate an understanding** of the principles of salary/bonus sacrifice  
**analyse** each of the following:
  - *reasons for adopting salary/bonus sacrifice*
  - *criteria to be an effective sacrifice arrangement*
  - *scheme design considerations*
  - *National Insurance savings to employer/employees*
  - *effect on State benefits*
  - *communication to employees*
  - *tax implications*
  - *contract of employment implications*

8. **demonstrate an understanding** of flexible benefits

**analyse** each of the following:

- reasons for offering flexible benefits
- designing a flexible benefits package:
  - core benefits
  - degree of flexibility
  - delivery of a flexible benefits package
  - employee communications

**explain** each of the following:

- the impact of automatic enrolment
- retirement provision options
  - additional contributions
  - salary sacrifice
  - rates of accrual
- taxation implications and effect on State benefits
- life events
- contract of employment implications

9. **outline** the impact of tax charges for individuals

**analyse** each of the following:

- disguised remuneration
- cash alternatives
- ill health

10. **outline** future developments

**explain** the impact of recent developments

# PART 1

## EMPLOYEE BENEFITS STRATEGY

### OVERVIEW

An “employee benefit” package is the total employment deal offered to an employee by an employer. This includes not just pay, but also other benefits such as pension, holiday, life assurance and healthcare to name just a few.

The various terms which are used when setting an employee benefits strategy are defined in Chapter 1. It also looks at some of the items of legislation that affect pay and therefore the overall benefits strategy. Chapter 2 outlines some of the elements that are included in an “employee benefit” package in more detail. It also looks into the importance of the package and the ways in which each element may be valued. The Chapter sets out how employee benefits strategies are defined and the process which may be adopted in order to agree and communicate the package to employees. It outlines the various roles involved in setting a benefits strategy and how they interact with each other. It also discusses how benefits are taxed and what impact they have on pension scheme benefits, if any.

By the end of the Part, you should understand what factors need to be taken into account when developing an employee benefits strategy.

# CHAPTER 1

## Introduction to Reward

### INTRODUCTION

In this Chapter we introduce the concepts of reward and remuneration and the constituent elements. In addition, we outline legislation that concerns pay, including equality and the minimum / living wage

When you have finished this Chapter, you will understand how a total reward framework is constructed and the relevant legislation that covers pay.

### 1.1 DEFINITIONS USED WITHIN EMPLOYEE BENEFITS STRATEGY

Various terms are used to describe both the total of an employee's remuneration and the individual component parts. Some terms are defined by law and others by common usage and the two do not always agree. The definitions set out below identify both legal and common usage of these terms where these contradict each other.

#### 1.1.1 Total Remuneration

Total remuneration describes the full value of an employee's contractual remuneration and this includes: pay, benefits both pension and non-pension, incentives, overtime, bonus.

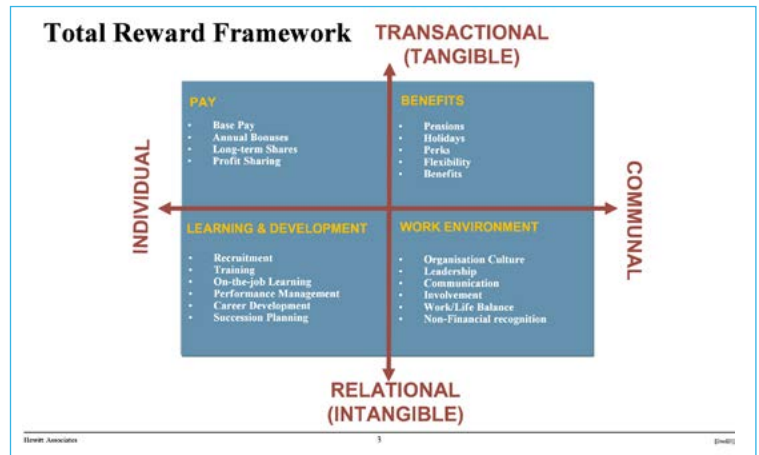
#### 1.1.2 Total Reward

Total reward includes everything listed above under total remuneration but also includes non-contractual and less tangible elements of reward such as: recognition plans, car parking, training and development, working hours' flexibility, working environment. The diagram below illustrates the HR best practice model of total reward, and this is often framed as "the employment deal". In this model certain elements are defined by corporate strategy as communal elements of reward (on the right-hand side of the diagram) and all employees experience these – e.g., a flexible benefits plan. Certain elements are defined and experienced at the individual level (on the left-hand side of the diagram) – e.g., individual base pay or bonus. Further, some elements of reward are straightforward to value in monetary terms such as base pay or a company car (at the top of the diagram) whereas others are "intangible" (at the bottom of the diagram) and difficult to value such as training or work/life balance policies.

The most powerful way that reward strategy can be set is if it is set in a holistic way where all elements of reward complement each other to support corporate objectives.

For example, Employer A is a growing company that wishes to promote a performance culture. A has a "top talent" training and development programme and this fits in with the bonus plan which rewards only exceptional performers and a share plan and base pay philosophy which strongly differentiates between average and exceptional performers. Here the reward elements reinforce each other within a "performance" related structure. The same company would have a consistent and fair pension plan, compliant with automatic enrolment legislation, which almost never reflects performance (due to governance and the long term and communal nature of pensions) and potentially a flexible benefits plan to contain all benefits which promotes individuality, choice, and employee empowerment.

By contrast Employer B also has a performance and growth culture but does not have a holistic reward strategy and has a mix of DB and DC pension vehicles, the longer servers being in DB, an aggressive stock policy that only the executive team can participate in, an incentive plan that pays out only to top performers based on company profit and a sales plan, that rewards on revenue volumes and a benefits plan, that preserves disparate legacy employers' benefits.



### 1.1.3 Pay

The amount of pay in the form of cash is determined by the contract of employment. In the European Union Treaty “pay” is defined as the ordinary basic or minimum wages or salary and any other consideration, whether in cash or in kind, which the worker receives, directly or indirectly, in respect of his or her employment, from his or her employer. When comparing jobs for the purposes of determining pay, benefits in kind, including pension must be considered. Although the UK has now left the European Union, equal treatment requirements still apply under the Equality Act 2010 (see 1.21, below).

Under the Employment Rights Act 1996 (ERA96), section 27, an employee’s “wages” are taken to include “any fee, bonus, commission, holiday pay or other emolument referable to his or her employment, whether payable under his or her contract or otherwise”. Certain other payments are also covered by the definition such as statutory sick pay and statutory maternity pay but others, such as pension payments and redundancy payments, are specifically excluded.

However, in common people management practice the term “pay” is used to describe solely the cash elements of reward and typically this includes:

- Base pay
- Bonus and commission (if relevant)
- Overtime
- Allowances (e.g., London weighting, unsocial hours, home working)

### 1.1.4 Benefits

Benefits are non-cash elements of reward. They are often referred to as “benefits in kind” and constitute some or all the following (depending on the employer):

*Core company provided and funded benefits Company cars (eligibility according to job role)*

Life Assurance

Pension

Permanent Health Insurance

Private Medical Insurance (eligibility according to job role) Health screen (eligibility according to job role).

Pension is often the single most valuable benefit to employees. In addition, many employers provide other benefits through flexible or voluntary benefits plans where the employee can “buy” additional benefits from their gross or net pay (see later Chapter on flexible benefits). The kinds of benefits typically included in flex plans include:

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### *Voluntary, flexible, employee funded benefits*

Critical Illness Insurance  
Dental Insurance  
Travel Insurance  
Childcare Vouchers (tax and NIC effective under a specific tax exemption)  
Bicycles (tax and NIC effective under a specific tax exemption)  
Computers  
Retail vouchers  
Gym membership.

There are numerous other benefits that may be offered to employees via flexible or voluntary benefits plans.

In addition, employers also provide a range of benefits or facilities which are generally available to all employees, or all employees at a particular site or with specific roles. These items are not always referred to as “benefits”, sometimes the term “perquisites” is used but this term has become outdated now. These additional benefits are not individually granted, are non-contractual but are provided to satisfy one or all of:

- employer’s perceived duty of care or culture
- industry norm, and/or
- legacy and site-specific benefits which are relatively cheap to provide but valuable to employees.

### *Community benefits or perquisites*

On site sports facilities  
Staff canteen (subsidised or free)  
Free tea and coffee  
Free car parking  
Employee Assistance Programme (confidential help and advice line)  
Newspapers  
Professional subscriptions  
Occupational health  
Luncheon vouchers  
In house childcare  
Retirement counselling.

In addition, there are a number of areas where employers may provide more generous terms than they are required to by statute or where more generous terms are deployed as part of wider HR policy, but are only applicable in certain situations.

### *Situation related policies*

Relocation packages  
Additional maternity leave  
Additional paternity/adoption leave  
Enhanced redundancy packages  
Season ticket or other staff loans  
Sabbatical leave  
Leave related to community or charitable projects  
Matching employee charitable contributions  
Supporting or part funding employee voluntary training/education  
Accommodation (eligibility according to job type and role).



### 1.1.5 Incentives

Incentives may take many different forms. Some jobs are structured around incentive plans for example sales roles, some jobs have a contractual right to a bonus for example senior executive roles and some jobs have no formal structure or right to receive an incentive but still may do so. Incentives include cash-based plans such as:

- Annual bonus
- Sales commission
- Performance or productivity bonus
- Profit sharing plans.

Incentives may also include non-cash plans such as stock plans, and these come in many forms Share Save, Save As You Earn, Employee Share Plans, Long Term Incentive Plans etc. In addition, recognition plans, long service awards and staff suggestion schemes are designed to reward employees for exceptional performance and often take the form of gifts, dinners, wine, retail vouchers, and theatre/event tickets.

### 1.1.6 Taxation

“Emoluments” or remuneration from any office or employment is subject to income tax and certain share plans are taxed via Capital Gains Tax. The definition of emoluments is extremely broad. It includes all salaries, fees, wages, benefits, and profits whatsoever. Generally, any payment of money, or anything capable of being turned into money, by an employer to an employee on account of services rendered will constitute emoluments. Certain emoluments and in particular certain benefits are subject to tax exemptions or tax advantages. Reimbursement of employees’ expenses incurred during the performance of their work duties are not taxable as long as they comply with the relevant legislation and guidance from HMRC (e.g., approved mileage rates for travel expenses).

## 1.2 ADDITIONAL INFORMATION IN RESPECT OF PAY

This section introduces some of the most important legislation in this area, including equal pay and the minimum wage.

### 1.2.1 Equal Pay Legislation

The Equal Pay Act 1970 relating to “equality” for men and women came into force on 29 December 1975. The Act, as amended by successive discrimination statutes, established the right of men and women to equal treatment relating to terms and conditions of employment:

- when they are employed on the same or broadly similar work or work that, though different, has been given equal value under a job evaluation scheme, or
- work that is of equal worth in terms of the demands of the job.

The Act applies to men as well as women and to full and part time employment.

The Equality Act 2010 repealed and replaced the Equal Pay Act 1970 from 1 October 2010 (subject to transitional provisions). However, the ‘equality of terms’ provisions in the 2010 Act are largely intended to replicate the effect of the 1970 statute. There are significant changes, but these are beyond the scope of this module.

From 1 January 1996, provisions contained in the Pensions Act 1995 mean that all occupational pension schemes must contain an equal treatment rule.

### 1.2.2 National Minimum Wage (NMW) and National Living Wage (NLW)

The National Minimum Wage Act 1998 covers the pay of “workers”. Section 230(3) of the ERA96 defines a worker as “an individual working under a contract of employment, or any other contract”. The individual undertakes to perform personally any work or services for another party who is not a client or customer of any profession or business undertaking carried out by the individual. In practice, this means that only the genuinely self-employed are excluded.

Any worker in the UK aged 18 or over, is entitled to be paid at least the level of the National Minimum Wage for every hour they have worked for an employer. This includes apprentices, employees of sub-contractors, agency workers, home workers, temporary and casual employees, and those on fixed term or freelance contracts.

From April 2016, the Government introduced a new mandatory National Living Wage (NLW) for workers aged 25 and above, initially set at £7.20 – a rise of 70p relative to the prevailing NMW rate, and 50p above the increase to the NMW due to come into force in October. That meant a £1,200 per annum increase in earnings for a full-time worker on the then current NMW. The NMW will still apply for workers aged 24 and under.

### 1.2.3 The Current Minimum Wage Rates

These rates are for the NLW and the NMW from 1 April 2020. From 1 April 2021, the National Living Wage was extended to 23- and 24-year-olds (previously it applied to those 25 and over).

Year	23 and over	21 to 22	18 to 20	Under 18	Apprentice
April 2020	£8.72 (25+)	£8.20 (21-24)	£6.45	£4.55	£4.15
April 2021	£8.91	£8.36	£6.56	£4.62	£4.30
April 2022	£9.50	£9.18	£6.83	£4.81	£4.81
April 2023	£10.42	£10.18	£7.49	£5.28	£5.28

Current rates of NMW and NLW can be found at - National Minimum Wage and National Living Wage rates - GOV.UK ([www.gov.uk](http://www.gov.uk))

Apprentices can get the apprentice rate if they're under 19 or in the first year of their apprenticeship. They're entitled to the minimum wage for their age if they either:

- are 19 or over
- have completed their first year

When calculating pay for NMW and NLW purposes, some of the main items included are:

- basic pay
- incentive pay and bonuses
- employer provided accommodation.

However, other elements such as benefits in kind, expenses and redundancy payments are excluded. There are also rules on the definition of “working time” so whilst overtime should be included, typically travelling time between home and work will not count.

### 1.2.4 Exclusions from NMW and NLW

There are no variations or exclusions based on region, size of employer, industrial sector, or occupation. Workers cannot be excluded from the NMW/NLW on the basis of hours, employment pattern and period of service or contract status.

The main exclusions allowed under the National Minimum Wage Act and National Minimum Wage Regulations are:

- workers who are genuinely self employed
- workers who are under the age of 18. Since 1 October 2004 workers aged below 18 who have ceased to be of compulsory school age qualify for the national minimum wage. The Regulations set an initial hourly rate of £3.00 for such workers. This has subsequently increased (see above)
- workers who live in their employer's home, such as "au pairs"
- voluntary workers who are paid only expenses – if the volunteer either works for a charity, voluntary organisation, charity shop, school, hospital, or similar body, and receives only reasonable expenses or benefits in kind such as subsistence or accommodation; or is placed by a charity, or similar body, with another charity or similar body, and receives money for subsistence
- members of the employer's family
- company directors
- workers on work experience who are not trainees with a contract of employment
- trainees on government funded training schemes, unless they are employees
- students on sandwich courses and teacher trainees
- homeless people on schemes where they do some work in exchange for shelter
- members of the armed services
- people who normally work outside the UK
- prisoners
- those in the fishing industry paid only by a share in profits of the fishing vessel
- people living in a religious or other community.

Detailed guidance on calculating the national minimum wage can be downloaded at – Calculating the minimum wage - Guidance - GOV.UK ([www.gov.uk](http://www.gov.uk)).

### 1.2.5 Statutory Sick Pay (SSP)

The benefits that an employee may receive whilst away from work due to sickness consist of amounts paid by the employer together with State benefits.

Under the statutory sick pay scheme, legislated for by the Social Security Contributions and Benefits Act 1992 and associated regulations, in certain circumstance employers pay statutory sick pay to their employees. Payment of statutory sick pay is dependent on the employee satisfying rules regarding periods of incapacity, periods of entitlement, qualifying days and, at the discretion of the employer, rules on notification of absence.

The weekly rate for SSP is £109.40 (2023/24) for up to 28 weeks. It is paid:

- for the days an employee normally works - called 'qualifying days'
- in the same way as wages – e.g., on the normal payday, deducting tax and National Insurance

### **1.2.6 Statutory Maternity Pay (SMP), Statutory Paternity Pay (SPP) and Statutory Adoption Pay (SAP)**

Statutory maternity pay was introduced on 6 April 1987. It is payable to employees who take maternity leave or leave employment because of pregnancy or childbirth and who satisfy certain qualifying conditions. SMP replaced the old system of maternity provision under which women could receive maternity allowance from the State and, where applicable, maternity pay from their employers. Although this system no longer operates, State maternity allowance is still available (subject to certain conditions) to women who are not entitled to receive SMP. With effect from April 2008 an employee is entitled to SMP for a total of 39 weeks. The rate for SMP is as follows:

- For the first six weeks – 90% of the average weekly earnings with no upper limit
- Remaining 33 weeks – The lower of the standard rate of £172.48, for 2023/2024, or a rate equal to 90% of average weekly earnings.

Where statutory maternity pay is properly paid, it can be reclaimed, in part, from the Government by way of deductions from National Insurance contributions.

- Statutory Paternity Pay (SPP) may be payable for a period of up to two weeks
- Statutory Adoption Pay (SAP) may be payable for a period of up to 39 weeks.

All employers are entitled to recover 92% of the SMP/SPP/SAP they pay.

If they qualify for Small Employers' Relief, they are entitled to recover 100% of the SMP/SPP/SAP they pay plus 3.0% as compensation for NICs they pay on the SMP. The Small Employers' Relief Threshold is an annual total Class 1 NICs of £45,000 or less.

### **1.2.7 Suspension on Medical Grounds**

Some jobs are covered by special health and safety regulations under which employees may be suspended from normal work on medical grounds. The Employment Rights Act 1996 provides most employees who are suspended under the regulations with the right to pay for a limited period during suspension. At present regulations under which employees can be suspended on medical grounds are concerned with jobs involving exposure to ionising radiation, lead, and certain other chemical substances.

Pay for the suspension may not be made where the:

- employee is otherwise incapable of work due to illness
- employee unreasonably refuses an offer of suitable alternative temporary work
- employee does not meet reasonable requirements concerning availability for work.

The amount that must be paid is a "week's pay" for each full week of suspension, proportionately for part weeks. The calculation date is the day before the day on which the suspension begins.

Certain groups of employees are excluded from this right.

### **1.2.8 Tax Credits**

Working Tax Credit replaced, among other things, the adult elements of Working Families' Tax Credit (WFTC) and the Disabled Person's Tax Credit (DPTC) from 6 April 2003. It is for working people, whether or not they have a child.

Child Tax Credit replaced the child related elements of WFTC and DPTC, plus the Children's Tax Credit from 6 April 2003. From April 2004, it replaced the child elements of Income Support and income-based Jobseekers Allowance. Along with the childcare element of Working Tax Credit, it is paid directly to the person in the family who is mainly responsible for looking after the children.

Details of both tax credits can be found online at - <https://www.gov.uk/browse/benefits/tax-credits>. See, also, section 1.2.12 Reform – Universal Credit.

### **1.2.9 Redundancy Pay**

Employers are required to make a lump sum compensation payment, called a “redundancy payment” to employees dismissed because of redundancy. The statutory minimum amount of the payment is related to the employee’s age, length of continuous service with the employer and weekly pay up to a maximum. The employer must also give the employee a written statement showing how the payment has been calculated, at or before the time the redundancy payment is made.

Employees who have not completed two years’ continuous employment have no entitlement to a redundancy payment.

The maximum length of service used in calculating statutory redundancy payments is 20 years and weekly pay is capped at 643. The maximum amount of statutory redundancy pay is £19,290. Both figures are for 2023/2024.

### **1.2.10 Pay during the Notice Period**

Sections 87-91 of the ERA96 set out the entitlement of employees to be paid during their notice period in certain circumstances. The following provisions apply only if the employer uses the statutory minimum periods. If notice periods are given that exceed the statutory minimum periods by a week or more, the following provisions do not apply.

Employees must be paid their normal rate of pay during the notice period if they are:

- available for work but the employer does not provide anything to do
- unable to work due to sickness or injury
- absent due to pregnancy or childbirth
- absent under contractual holiday provisions
- absent due to taking parental leave.

In any of the above situations, the amount that must be paid is a week’s pay for each week of statutory notice. Any contractual payments, including SSP, SMP, SPP and SAP made by the employer for the absence go toward meeting the liability. The employer is not liable for any day of leave requested by the employee, or for any day for which payments are due under the paid or unpaid time-off provisions of the ERA96.

Therefore, if the employee is sent home and paid in lieu of notice, the payment must be at least the amount of a week’s pay for that employee for each week of statutory notice entitlement.

### **1.2.11 Exclusions from Pay during Notice Period**

If the employee gives notice, the same payment rules apply for just one week of statutory notice, but no payment is due unless the employee actually leaves. There is also no liability if the employee takes part in industrial action during the notice period.

The following groups of employees are excluded from this right:

- members of the armed forces
- House of Lords staff
- House of Commons staff
- employees working at any time outside of Great Britain
- people working at sea under a crew agreement.

### 1.2.12 Reform – Universal Credit

Universal Credit is a single payment for people who are looking for work or on a low income.

Universal Credit is intended to help claimants and their families to become more independent and simplify the benefits system by bringing together a range of working-age benefits into a single payment.

Universal Credit will replace certain benefits but is being introduced in stages depending on eligibility and where a person lives. It will be fully implemented by the end of 2024.

Universal Credit is replacing:

- Jobseeker's Allowance
- Housing Benefit
- Working Tax Credit
- Child Tax Credit
- Employment and Support Allowance
- Income Support

According to the government's welfare reform timetable, Universal Credit will be established across the UK by 2016 with new claims to legacy benefits closed from 2016 – with migration to follow thereafter. Some key points are:

- Universal Credit requires claimants to accept a 'Claimant Commitment'. This sets out what is expected in return for receiving assistance, taking into account personal circumstances and capability to earn.
- Claimants will be able to apply for their benefits online. Nearly 80 per cent of benefit claimants already use the internet. Telephone and other support services available if needed.
- Designed to make work pay. As claimants earn more money, financial support will be withdrawn at a slower rate than is the case under the current system. Real Time information (RTI) link with HMRC will facilitate this.
- A single payment will be made to a household rather than an individual. This will include housing costs. It will be paid monthly, in arrears. This will enable a household to clearly see the effect of their decisions on their overall income, encouraging responsibility for budgeting.

For further information, see the government's employer and individual guides at -

<https://www.gov.uk/guidance/universal-credit-toolkit-for-partner-organisations>.

#### Summary

This Chapter has outlined various important definitions used in connection with employee benefits strategies. These have included definitions of pay and benefits.

It has also outlined a number of other statutory aspects of pay. These included:

- Equal pay legislation
- Minimum wage legislation
- Maternity, Paternity and Adoption pay
- Medical, tax and redundancy.

#### Self Test Questions

- What is the definition of pay?
- What are the typical core benefits?
- Are there any regional exclusions to the national minimum / living wage?
- Outline the main features of redundancy pay.

# CHAPTER 2

## Employee Benefits

In this Chapter we explore employee benefits in more detail. This includes the development and communication of a benefit strategy. In addition, we outline the tax implications of benefits.

When you have finished this Chapter, you will understand the factors which help to determine an employee benefit strategy and the options available for communicating it.

### 2.1 EMPLOYEE BENEFIT COMMUNICATION

Many leading employers set their reward strategies in a holistic way that is at the “total benefits” level, rather than a piecemeal approach where the strategy and policy for each element of reward is identified individually. It is also known as “Total Remuneration”, which is the combined value of all cash payments and benefits provided by an employer to an employee. A total remuneration strategy is therefore assessed, set and expressed in a holistic way. In the eyes of employees’ total benefits are communicated and valued in a holistic way via a Total Reward Statement usually on an annual basis.

Adopting a total benefits approach helps raise the awareness and understanding of each reward element and its monetary value as well as the value of the overall reward package.

#### 2.1.1 Employee Benefit Communication

##### *Total Benefit Calculation*

An example of what a total benefits calculation would look like is set out below:

##### **Example**

An employee receives a basic salary of £25,000 and a number of other benefits. The value of the total package is shown below:

	<b>Annual cost £</b>
Basic salary	25,000
Pension (employers contribution - 10% of basic salary)	2,500
Company car	6,000
Private medical insurance (family level)	800
Life assurance (3 x basic salary)	100
Bonus	6,000
<b>Total Benefits</b>	<b>£40,400</b>

**i.e. the basic salary is 62% of the total benefits package.**

The impact of this calculation in the eyes of the employee is the scale of the whole package value. For communication purposes employers often provide valuations such as this and in addition, written notes on other “intangible” elements of the package such as car parking and staff canteen to present a whole picture of reward. Total reward statements such as this are provided annually in either paper form or online, generally packaged with the employer’s branding and business and people agenda messages.

### **Why is employee benefits communication important?**

Employee benefits communication can:

- raise awareness of the different package elements
- shift the focus away from basic pay only
- increase the understanding of the package
- provide a common framework in a merger/acquisition situation
- aid recruitment, motivation, and retention
- be applied to all employees.

By adopting this approach, companies are often able to quantify for the first time how much they spend on employees over and above basic salary and other cash compensation payments. Companies will often find that they typically spend between 10% and 50% of salary on benefits on top of the base salary itself. The higher level would be more applicable to senior employees and DB pension plans.

The Pensions Regulator (TPR) has also issued guidelines on Effective Member Communications. The guidelines set out principles of good practice and provide examples to help trustees, managers and employers to consider what they are trying to achieve and determine whether their written communications are successful. The full guidance notes can be found at [Communicating reporting DC pension schemes | The Pensions Regulator](https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/tpr-fca-employers-trustees-financial-matters-guide.ashx). TPR has also issued a factsheet that provides information to employers and trustees on what they can do without the need to be authorised, including information on giving advice and on promotions - <https://www.thepensionsregulator.gov.uk/-/media/thepensionsregulator/files/import/pdf/tpr-fca-employers-trustees-financial-matters-guide.ashx>.

### **2.1.2 How to Value Benefits?**

Benefits can be valued in a number of different ways, namely:

- employer cost, either on an individual basis or on an average basis
- employee cost.

#### *Employer Cost*

The employer cost is the cost charged to the company. This is likely to be lower than the cost an employee would be able to benefit from if they were to purchase the benefit themselves on the open retail market. This is on the basis that companies can benefit from lower costs due to their bulk purchasing power. The larger the company, the greater the potential discount.

The employer cost can be calculated on an individual basis for each employee or on the basis of an average cost. This is where the total spend of the employer is used and is split on a per head basis amongst all employees.

#### *Employee Cost*

The employee cost is also known as “the replacement cost” or the “walk away cost”. Essentially, the employee cost represents what it would cost the employee to replace the benefit they currently enjoy from the employer, were they to walk away from the company. Typically, the employee will pay more for benefits since it is an individual cost.



### Example

An example of the difference in the employer and employee cost is shown below:

<b>Employer Cost Benefit</b>	<b>£</b>	<b>Employee Cost Benefit</b>	<b>£</b>
Company car	6,000	Car	8,000
Private medical insurance	800	Private medical insurance	1200
Life assurance	100	Life assurance	200
Permanent health insurance	120	Permanent health insurance	250
Travel insurance	60	Travel insurance	110
<b>Total</b>	<b>7,080</b>	<b>Total</b>	<b>9,760</b>

It is clear from the example how different these two costs can be. If the employee were to replace the same benefits in this example as the employer currently provides, it would cost an additional £2,680 net pay.

### *When to Use the Different Valuation Approaches*

The employer cost and employee cost approaches may be used in different situations as set out below.

The employer cost approach may be used in the following situations:

- recruitment
- introduction of flexible benefits
- total reward statements.

#### *Recruitment*

An example of this might be in advertising a job vacancy. At all levels of recruitment, a generic statement setting out the overall benefits package is beneficial. Particularly at senior levels, this approach may be used to identify any differences between the package value from the previous position versus the new position. Whilst the elements may not be the same, the purpose of such an exercise would be to demonstrate that the overall package value has increased.

#### *Introduction of Flexible Benefits*

Where companies intend to introduce flexible benefits, they may often firstly adopt a total remuneration communication approach. Benefit costs under flexible benefits plans tend to reflect employer costs and therefore if the total remuneration statement is part of the communication in the introduction of flexible benefits, this too would need to reflect the same cost. Successful flexible benefit plans require clear education and understanding of the separate elements.

#### *Total Reward Statements*

These statements are typically issued on an annual basis to employees.

The employee cost approach may be used in the following situations:

- external benchmarking
- mergers and acquisitions.

#### *External Benchmarking*

This is when a benefit or, a number of benefits, are compared to those provided by other companies in the marketplace. Typically, the cost of a benefit for an organisation is based on the size of the organisation. So, the larger the company, the greater the bulk purchasing power and the lower the cost of the benefit per head. Using the employee cost or the replacement cost allows a more direct comparison to be made. This approach is becoming increasingly rare in the employment market as discounts which reflect company size are being eroded.

### *Mergers and Acquisitions*

Frequently in a merger or acquisition situation, employees may feel that they may lose out in terms of their reward package as a result of adopting one company's benefits package over another. Some companies will use the total remuneration approach to show the value of the package before and after the acquisition situation. As no two organisations will have the same reward package, ideally, this approach will show that, in aggregate, the packages are at least comparable.

## 2.2 EMPLOYEE BENEFIT PHILOSOPHY AND STRATEGY

An employer who decides to set benefits strategy in a holistic way and then determines some guiding principles in respect of that strategy is essentially developing a total employee benefits philosophy. The guiding principles are determined by reference to:

- the nature of the business (e.g., a small entrepreneurial start up technology company would have a different nature to a mature family company)
- the sector the business operates within
- the views and philosophy of the business owners
- cost constraints and guidelines.

Examples of employee benefits philosophies are set out below:

### **Company C - a long established engineering company**

- Benefit entitlement will be set to reflect the market in this sector
- Benefit entitlement will be determined by organisational grade
- Employees will be given restricted choice and access to tax effective benefits where possible
- Risk benefits such as life, permanent health insurance will be provided as a fixed entitlement to all employees and private medical will be granted according to role
- Benefits will be viewed as company care and protection policies
- Incentives will be provided in the form of cash bonus for certain roles only
- Base pay will be defined by job role set out in a formal pay structure

### **Company D - a small technology company in its first 5 years of trading**

- Core risk benefits will be set at the minimum level to avoid the package being tied up in non-cash elements – all employees will have the same basic benefits
- Employees will have the opportunity to increase their benefits via a flexible benefits plan
- All employees are eligible for a bonus awarded on outstanding performance only
- Base pay is determined by the market and there is no formal structure

The above are philosophical statements rather than strategies, but they form the starting point for setting the strategy.

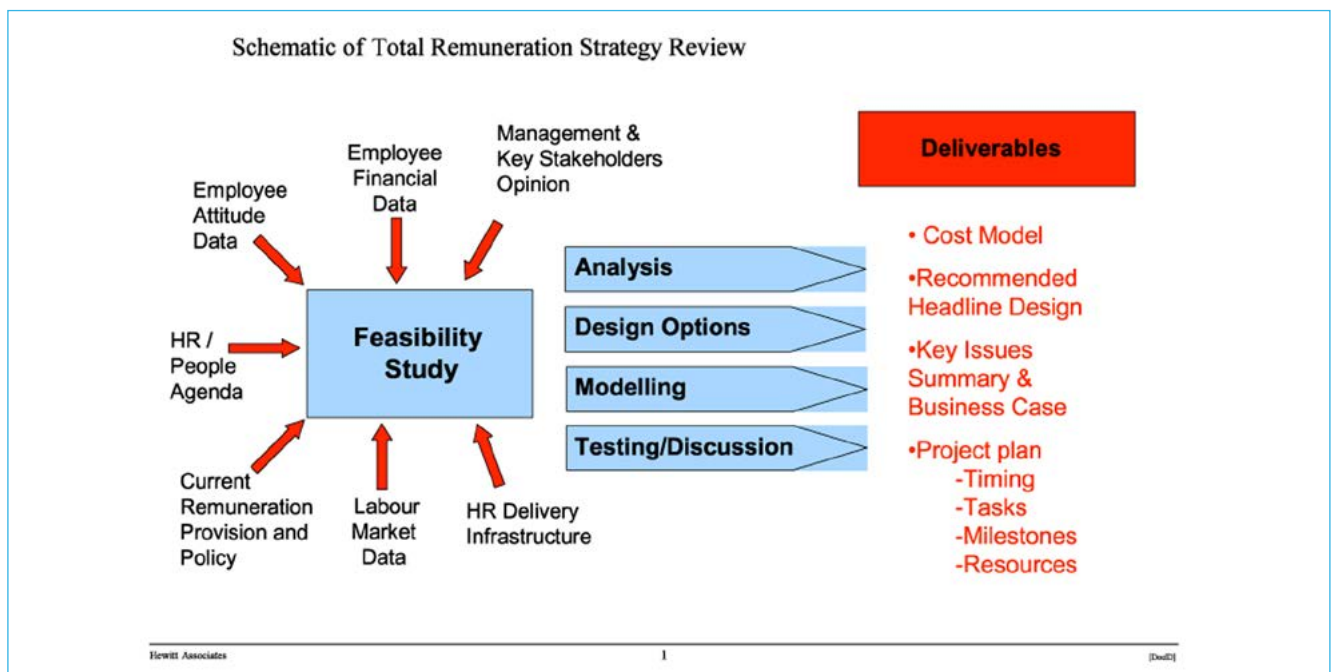
### **2.2.1 Employee Benefit Strategy**

Employee benefits strategy is then developed by reference to a number of external and internal factors but ultimately it is driven by the employer's business and people objectives. Very few businesses can set a benefits strategy starting with a blank sheet of paper and so the process often starts with researching and understanding how the current situation has developed. Ideal strategies are then developed and an implementation plan will focus on moving from the current state to the ideal or holistic total reward strategy. Legal and labour relations considerations will impact the degree and pace of change.

Any populations which have been transferred to an employer as part of a corporate transaction will be covered by the Transfer of Undertakings legislation ('TUPE' or the Transfer of Undertakings (Protection of Employment) Regulations) which makes it difficult to alter terms and conditions of employment. In addition, any populations where there is compulsory collective bargaining via a Trade Union in place will require specific implementation actions. In general terms even where there are no TUPE issues or collective bargaining, implementing changes to terms and conditions of employment, pay and/or benefits requires employee consultation and in most cases consent. In practice employers implement benefits (excluding pensions) and pay changes by changing reward structure and sometimes with protection clauses and "no financial loss" guarantees. The process of consultation, employee consent and protective measures will vary enormously by business circumstances.

Special rules apply in relation to pensions where there is a TUPE transaction. This is covered within the core units.

In order to review a total benefits strategy the following process is generally followed.



### 2.2.2 Factors to Consider in Developing and Managing an Employee Benefit Strategy

#### *Market position*

Employers should identify where they would like to position their total remuneration and individual remuneration elements against the labour market. For example, in the oil sector many employers still offer a Defined Benefit pension arrangement, so for a new oil company establishing in the sector, they have to decide whether to match this or if not, how well funded a DC plan might be. Here their yardstick is market practice in that sector. By the same token each element of pay and benefits provision can be benchmarked against market data. Market data is collected and collated by HR and reward consultancies and sector/trade associations, sometimes there is sector specific data and sometimes studies are done to cover employers by size (turnover or headcount) or to cover "general industry" as a whole.

Most employers specify the extent to which they position themselves in the labour market against the headings of: Base pay; variable pay; pension; other benefits; and benefit structure.

### **Example of a typical market strategy – High performance pharmaceutical company**

Base pay = to be set at market median rates for all roles with reference to the pharmaceutical sector

Variable pay = to be set at upper quartile for all sales, R&D and management roles and median for all other roles

Pension = to be DC in structure with employer contribution levels which are at market median

Other benefits = to be set at market median except for private medical cover which is to be made available to all employees

Structure = to offer value, tax effectiveness and choice through a flexible benefits plan that represents market median practice

### *Employee demographic and segments*

Employee demographics will influence the perceived value of different elements of reward. Demographics in this context includes:

- Age
- Socio-economic grouping
- Cultural/racial origin.

Different types of employees value different elements of reward. Typically, employees over 40 years of age are much more pension, life assurance and medical insurance focused than their younger colleagues. Younger workers tend to value cash above all but generally respond very well to benefit flexibility and performance related variable or bonus pay. Socio-economic grouping will tend to influence attitudes to benefits and whilst this is a large generalisation, the lower paid and blue-collar workforces tend to focus solely on cash and not value items like insurances even if they are entitled to them. The prevalence of Trade Union membership within an employer may also influence attitudes to benefits. Often Trade Union membership brings with it discounted rates for life assurance and some types of health insurance which makes the provision of these benefits by the employer relatively less valuable. Cultural/racial origin of workers may also influence attitudes to the total remuneration deal, sometimes in subtle ways. The way this plays out in organisations can vary enormously but for example in large Muslim dominated populations, the provision for additional leave (paid or unpaid) to allow employees to attend the Haj in Mecca can be highly appreciated. In addition, the provision of quiet room prayer facilities can be valued by many religious groups.

The key to considering employee demographics is for employers to understand and analyse populations by demographic segments and then consider the impact of different types of reward. It is easy to over generalise about “what motivates who” so it is always better to conduct some employee attitude analysis or direct employee listening to understand what employees value.

### **Example: Employer E – an engineering and quantity surveying business**

- Employer E had a traditional pay and benefits structure for an old established, unlisted professional firm namely: market average base pay; small bonus potential; a DB pension plan; life cover (4x); 26-30 days holiday depending on grade; family medical cover for senior managers and cars for job-need managers. There was a structured programme to support employees studying for professional qualifications. Average age of the workforce 43, average earnings £35,000.
- The market and nature of the sector shifted considerably over a 10-year period meaning that different skills and different types of employees needed to be hired. Language skills, higher IT literacy, sales and marketing skills and more internationally mobile employees were required and less fully qualified civil engineers and quantity surveyors. A targeted graduate recruitment programme was established and the total remuneration strategy was revised. The company recognised that its current remuneration structure would not attract, motivate and retain graduates.
- The new benefits strategy encompassed:
  - Base pay unchanged broadly but there were some cash bonus programmes designed to retain graduates for more than 3 years
  - Higher bonus potential but against stringent performance targets
  - DC pension
  - Flexible benefits plan to encompass all benefits and allow maximum flexibility to spend on benefits fund and salary. Minimum or core benefits set at 2 x life cover, 20 days holiday, 3% employers pension contribution (allowing an opt out but not to release cash). Employees were thus given the freedom to maximise their cash or take advantage of tax efficient benefits and discounts.
- Three years after the change the average employee age had fallen to 38 by a combination of retirement and new hires, and the average salary had fallen to £33,000. More importantly, the business had the right blend of skills to serve their changing market.

### *Global and Group structure and culture*

International businesses may be influenced by the style and philosophy of the parent company and while local country businesses may have certain freedoms, parts of remuneration strategy will be driven by global plans. Stock plans, promotion, sales incentives and often cash bonus plans are driven by global structures. Pension plans and recognition plans are usually driven locally. Some international groups have a highly decentralised philosophy and therefore local business units have the freedom to set most of the remuneration strategy. Typical examples of group or global influence are set out below for companies in the same sector (professional services) of similar sizes, but the nature of group influence will vary enormously from business to business.

## Reward and Retirement Provision

Reward element	US owned	French owned	UK owned
Base pay	Local market rates Global rates for executives	Local market rates	Local market rates
Variable pay	Global plans all employees participate at some level within the plan. High potential upside.	Global plans all employees participate at some level within the plan. Medium/low potential upside.	Global plans but often for management grades and sales only.
Promotion criteria	Global	Local	Global at senior levels, local elsewhere
Pension	DC – minimal funding levels	DC but well funded	DB/DC* – moderate funding for DC, DB significant funding levels
Cars	None	Job need only	Job need and management
Insured benefits – health, life etc	Health funded private in full. Other benefits moderate/low funding	Low/moderate funding. State provision covers health etc	Funding varies widely by organisational level

\* Increasingly DC-only with over 90% of DB pension schemes closed to new entrants.

### *Management style*

Management style will be strongly influenced by the group factor mentioned above however a change of Chief Executive or other senior executive can influence remuneration. Examples of this include a new Chief Executive granting an extra day's holiday across the workforce or introducing a new profit-sharing arrangement. In addition, a change of HR Director or other senior HR positions can radically shift items such as variable and base pay or effect the introduction of a flexible benefits plan or performance related pay for the first time.

### *Cost management*

Cost management will always have a strong influence over employee benefits strategy. In many cases cost management is the prime driver and other factors work around cost constraints. Since employee benefits can have a direct influence over people performance, many reward structures are modelled both in cost and revenue enhancement terms. For example, sales incentives are structured to drive volumes, margins, or both. All incentives are intended to be in some part self-funding, as they reward enhanced business performance. All proposed changes to benefit strategy should model cost and revenue impact. Some elements of benefits reflect simple costs which have minimal direct business impact but influence the composition of the overall remuneration "deal", e.g., Employee Assistance Programmes, car parking on site. The table below summarises some of the main opportunities to impact cost against some of the main elements of employee benefits strategy.

## Reward and Retirement Provision

Reward element	Potential cost impact	Notes
Base pay	High – generally structural change can reduce costs but most pay changes are upwards	Headcount reduction is the most common form of cost reduction in this area
Variable pay	High – structure change and smarter use of performance triggers can positively impact revenue as well as cost.	Considerable focus in this area for many businesses
Pension	High – funding levels – employee and employer, structure, nature or plan type	<ul style="list-style-type: none"> <li>• DB to DC pensions is one of the biggest pension issues of the last 15 years in the UK</li> <li>• Pension salary sacrifice can save -1% of the pay bill on introduction</li> <li>• Automatic enrolment and increases to minimum pension contributions will drive up pension costs for employers with current low pension scheme membership</li> </ul>
Insured benefits – life, health, permanent health	Moderate and for some benefits low impact	<ul style="list-style-type: none"> <li>• Health benefits and policies can positively influence absence levels and so reduce the overall corporate cost of health (see health benefits Chapter)</li> <li>• Broking can deliver significant cost savings to employers, influenced by the market price and by benefit plan design</li> </ul>
Cars	Moderate	Cars salary sacrifice can save costs for both employer and employee
Tax and NIC effective benefits	Moderate/Low	Employers' NIC may be saved by employers offering through salary sacrifice- childcare vouchers, bicycles, holiday buy, learning, car parking, computers
Flexible benefits	Moderate/low	<ul style="list-style-type: none"> <li>• Salary sacrifice benefits are best housed within a flex plan</li> <li>• Flex can also be used to harmonise terms and conditions of employment post merger for example, in a cost minimising way</li> <li>• Flex can buffer the impact of future benefit cost increases by passing the funding decision and impact from the employer to the employee</li> </ul>

### *Compliance and risk*

Employers must structure employee benefits strategy in accordance with relevant laws and taxation guidelines. With these change there is an opportunity to change designs to either minimise the impact of new law or to take advantage of new opportunities. For example, for a 5–6-year period in the 1990s the Government introduced a tax effective new profit related pay plan which over a period of 3 years was implemented in over 70% of UK employers with over 50 employees. There are few such substantial changes to the taxation of cash pay in the current climate (with the exception noted below) but legislation has an enormous impact on stock plans and pension provisions, and this continues to be the case.

Partly as a reaction to the crisis in the banking sector during 2007/08 and partly due to the ongoing public and government pressure on high pay and bonus in the sector, the Government introduced measures during 2008 and 2009 to curb and tax higher the bonus culture in the City. These measures target the financial sector and there are strict definitions which are used to apply the rules. This type of taxation measure is unusual, but it demonstrates that successive Governments may exert an ever greater influence over remuneration strategy moving forward.

Non pension benefits are generally taxed via P11D reporting and many benefits have rules which address specific taxation requirements and exemptions e.g., childcare vouchers and bicycles.

### **2.2.3 Abolition of the Default Retirement Age**

The default retirement age (DRA) of 65 allowed an employer to compulsorily retire employees at that age, provided that the employer follows the “duty to consider” retirement procedures. However, faced with an ageing society, the Government removed the DRA (and associated retirement procedures) from 6 April 2011. Transitional arrangements applied for the first six months and the DRA was removed completely from 1 October 2011. It will still be possible for an employer to operate a compulsory retirement age from April 2011, but this will need to be objectively justified as being a proportionate means of achieving a legitimate aim.

Employers will need to accommodate older workers. Whilst some workers will be committed to full-time work, there are likely to be more requests for part-time and flexible working and partial retirement by those who wish to wind down gradually. Employers may consider introducing flexible and voluntary benefits arrangements to address the changing needs of employees.

Older workers are typically paid more, reflecting their experience and length of service at a particular grade. As well as a higher wage bill, the costs of pensions and other employee benefits are likely to increase. Certain benefits linked to retirement may be difficult to justify.

Employers should have reviewed existing arrangements and considered necessary changes or improvements to age-related policies and practices relating to recruitment, retention, development, and employee benefits. References to “at normal retirement age”, or “by reason of retirement” etc. should have been altered or clarified.

Under UK regulations, it is also possible to withdraw group risk insured benefits at age 65 (or State Pension Age, if greater), subject to terms and conditions of employment

### **2.2.4 Employee Engagement, Input and Communication**

At the fundamental level all employers should identify what employees are seeking from their reward deal in order to design plans to achieve maximum motivation, employee engagement and understanding. Ways to obtain employee input include:

- Focus groups
- Written surveys which may be:
  - General covering how employees feel about their employment overall, these include formal engagement surveys; or
  - Specific to scrutinise a particular reward element of issue
- Liaison with employee representative bodies – these may be formal Trade Unions or less formal but still employee elected/nominated “works council” bodies
- Management surveys conducted through team meetings
- Email – “pulse” checks – e.g., short 6-7 questionnaires via email
- Involving employees and/or representatives in projects set up to redesign remuneration plans
- Surveys which assess which reward elements employees prefer over others, these are called statistical “conjoint analysis” surveys.



If employee input is utilised to inform remuneration plan design and communication, the evidence shows that the impact is far greater when the new plans are launched.

Communication of employee benefit changes is in some cases driven by law:

- Pensions change requires formal consultation
- Negative pay changes require formal consultation and in some cases employee consent
- Non pensions benefit changes may be achieved without formal consultation but in many cases, it is HR best practice to do so.

In order to communicate effectively with employees a wide range of communication media and methods can be used. Generally, the more attention paid to communication the greater the efficacy and simply sending out written documents seldom engages employees or achieves understanding or a change in behaviour. The appropriate methods of communication will vary according to the nature of the change. The table that follows sets out in general terms the types of communication and the level of potential impact.

Communication method	Impact when delivered
Brochures and booklets	Low-Medium
Email as a single message	Low
Email campaign	Low-Medium
Flash presentations or videos on email	Low-Medium
Flexible benefits interactive website	Medium-High
Employee presentations – face to face	High
Employee “clinics”, helplines, question and answer sessions, face to face	High
Active management sponsorship of changes working alongside employee presentations	Medium-High
1:1 or small team briefings for example in respect of a new sales incentive plan	High
Posters and “gifts” or promotional gimmicks	Low-Medium

The most effective communication of an entirely new or fundamentally changed benefits strategy will be a combination of the above methods planned as a communication campaign. Subtle changes can of course be communicated in simpler and less complicated ways.

### 2.2.5 Securing Benefit Suppliers

A change of benefit supplier can have a large impact on cost and benefit design. Care should be taken to secure good prices, but it is always important to read the “small print”. Some employers have had to face difficult issues when an employee claims under a policy and for some technical exclusion, the claim is delayed or denied. Skilled benefit brokers take claims history, service levels and relationship management into account as well as benefit design and price. The administration of benefits must also be considered and sometimes employers find themselves carrying out much administration for example managing claims, in house.

### 2.3 MEASURING AND EVALUATING BENEFIT AND REMUNERATION STRATEGY

As with all major business strategies, benefits strategy should be measured. Typically, objectives and measures for benefits strategy are set using some or all of the following measures. Many of these are embedded in the business budgetary cycle but some such as successful recruitment may not be.

Objectives and measures	Part of budgetary cycle Y/N
Annual cost per reward element	Y
Per head cost per reward element	Y
Sales incentive cost/Revenue growth	Y
Change in employee engagement score or changes in specific employee measures in respect of reward	N
Achievement of targets set for pay round negotiation/delivery	Y
Total remuneration bill overall and per head	Y
Proportion of job offers accepted	N
Staff turnover rate change	N
Market position against strategy	N
Cost of health and or cost of absence	N
Take up of benefits plans – pension, flexible benefits, SAYE etc	N
National insurance costs/savings	Y
Overall benefit plan administration cost	Y
Per reward element administration cost – internal and external	Y

As with many HR measures it is sometimes difficult to attribute cause and effect to some of these measures, e.g., employee engagement and staff turnover may be strongly influenced by remuneration strategy however both these may be in many instances more strongly influenced by other factors such as line manager relationship, business leadership and business results.

### 2.4 ROLES AND THEIR INTERACTION

Successful implementation of a flex plan is dependent on detailed planning and engagement of all the providers plus the payroll and HR teams.

This implementation is often built around 5 phases as follows:

- Defining the requirements
- Building the actual flex system which typically now includes a web front end
- Internal acceptance testing
- User acceptance testing
- Launch.

In order to provide a greater understanding of the flex implementation process and the respective roles and responsibilities of the providers and stakeholders and how they interact, it is useful to look at each of these phases in more detail.

### **2.4.1 Defining the Requirements**

This is the first phase of the project. The project manager and the subject matter expert (often someone from the organisation providing the flex service) will work with the employer to define the detailed rules for the flex scheme, for example, benefit eligibility (which employees and/or dependents are eligible to elect which benefits) and the structure of those benefits (such as levels of cover). As part of this first phase, the flex scheme provider will also define specifications for the provision and receipt of data for the various providers and HR and payroll. As there are potentially a large number of providers for a flex scheme, the administrator of the scheme can often only take data in a prescribed format. These specifications will then be issued to the relevant providers to enable them to build the data files so that these are available for testing in the later phases.

The requirements phase not only covers the flow of data but also defining the reports that need to be available to provide the management information the employer needs and any forms or communications that need to be issued.

It is important at this stage to not only consider the “go live” of a new flex scheme but also to specify which events, during a flex period, will allow an employee to revisit their flex options, for example, marriage, birth of a child and so on.

The final key element to this phase is to agree the “look and feel” of the website including the detail of the text and any branding or images.

### **2.4.2 Building the System**

Building the actual platform for the implementation of a new flex scheme will largely mirror the requirements phase outlined above. The first step will be to build the underlying rules, including those relating to a change of the employee’s circumstances after the flex window has closed, within an agreed structure.

Building the system will also include the output files mentioned above which will be sent to HR, payroll, and providers. These files are key as they ensure that the employee receives the benefits he or she has elected and that the correct deductions are made from the flex fund. The files need to be provided not only at the commencement or renewal of the flex scheme but also during the year to cover changes and new employees.

It is at this stage in the process that any web front end for use by employees will also be built based on the requirements gathered in the first phase.

Finally, it is important that a service is provided to answer employee queries. Some providers of flex administration operate helplines or service centres specifically for this purpose. Some employers choose to provide this service using their own HR teams.

### **2.4.3 Internal Testing**

This phase is the responsibility of the flex provider, whether that is in-house or outsourced. The build outlined above will be tested using a subset of the full employee data and this will include loading and validating the data, checking that the underlying rules covering benefit eligibility and elections are working correctly and that the system is delivering the required outputs in terms of files for the providers, management information and so on.

The flex process is not just about the system however and this phase should also cover testing all related processes and, where applicable, that teams manning any helpline have all the information they need to deal with queries from employees, for example some Frequently Asked Questions.

### 2.4.4 User Acceptance Testing

This is the point at which the employer will become involved in the testing phase by providing HR and payroll data files for testing. The employer will typically also be involved in testing the web site to ensure that it meets the requirements in terms of the benefits available to employees, the rules underlying those benefits and that it complies with any corporate guidelines on branding or look and feel.

### 2.4.5 Launch

Communications to employees about their benefits is covered elsewhere in this manual. During the launch period it will be important for the employer and the provider of the flex scheme to work closely together so that employee queries can be monitored, and further communications issued if necessary. Take up also needs to be monitored in case further promotion of the scheme is required. Employees usually have a window of 2 to 3 weeks in which to make their elections.

The above provides a very high-level overview of a flex implementation. It illustrates how important it is to engage with the providers and ensure the system is set up to manage the various data flows and ensure all providers and stakeholders receive the information they require when it is due and that the flex scheme operates in line with the requirements of the employer. Finally, communicating the benefits of the scheme to employees and helping them understand the choices available to them is material to the success of the arrangement so this also forms an important aspect of the plan.

## 2.5 DEVELOPMENT OF BENEFITS STRATEGY

Modern companies offer imaginative employment packages aimed at recruiting, retaining, motivating, and empowering their employees. Today benefits in kind play a key role in this. Despite a rather murky history, benefits in kind are an important tool of professional HR management.

Benefits in kind started in the late nineteenth century when unscrupulous employers used them to cheat employees out of a fair wage. Employees were paid, not in cash, but in vouchers that could only be spent at the company store. And the store's prices were never the cheapest in town! This practice was outlawed by the Truck Acts, which gave employees the right to be paid in cash.

Then in the 1960s and 1970s, benefits in kind became a means of tax avoidance, especially for senior managers who faced marginal tax rates up to 83%. The widespread popularity of the company car is a legacy from those days.

A "benefit" is anything that is given or provided to an employee that is not pay or expenses. Examples include:

- allowing an employee to use company property or equipment, for example a car or living accommodation
- giving an asset, for example a car or a television, to an employee, or selling it to an employee for less than it is worth
- providing a service to an employee, for example health insurance.

Today HMRC levies tax on the full cash value of benefits in kind. And headline income tax rates have been much reduced since the 1970s. However, in England and Wales, individuals now may pay a marginal rate of 60%, on taxable income between £100,000 and £125,140 (2023/24). This is because the annual allowance is clawed back by £1 for every £2 earned over £100,000. On earnings between £37,701 and £50,270 (2023/2024), an effective tax rate of 52% (NI Inclusive). On earnings between £50,270 and £100,000 the rate would be 42%. Nowadays, new benefits in kind are introduced as a tool of human resource policy. Some benefits, such as training or share options, give employees incentive. Others, such as medical insurance and childcare facilities, promote the image of a company as a "caring" employer.

### *Different Types of Benefits and Strategic Factors*

As explained earlier pensions are usually the most expensive and most valued benefit. Company cars can be of similar value and are usually the second most expensive but sometimes the most valued (by employees) benefit.

Pensions strategy is driven by:

- Compliance
- Cost
- Company culture and philosophy
- Employer paternalism
- Sector/market practice
- Company history.

Other benefits strategies are typically influenced by similar factors:

- Cost
- Company culture and philosophy
- Employer paternalism (often in respect of insurance benefits)
- Sector/market practice
- Company history
- Employee motivation and engagement
- Employee demographics and opinion
- Tax efficiency
- Wellbeing – physical, financial, and mental.

There are important differences between the factors which influence both types of benefits.

The best way to set benefits strategy is as an integral part of Total Remuneration Strategy but some employers separate policy and strategy between pay and benefits. This may be reflected in the HR organisation structure where there may be a “head of pensions and benefits” role and a separate “head of pay and reward”.

## **2.6 TAX IMPLICATIONS OF BENEFITS**

Under general tax law, most expenses payments and benefits are taxable remuneration.

Since 1948, income tax law has also contained special rules affecting most directors and certain other employees. The broad effect of these special rules was that expense payments made to them, and benefits provided for them became taxable.

The Finance Act 1976 and subsequent Finance Acts extended these special rules to a greater number of individuals and provided new arrangements for taxing a variety of benefits (for example cars, loans, and vans) provided for:

- directors and certain other persons in controlling positions whatever their remuneration. But the rules did not apply to certain full time working directors and certain directors of charities and nonprofit making concerns.
- employees, including the directors excluded above who were remunerated at the rate of £8,500 a year or more including all expenses payments and benefits before the deduction of any allowable expenses other than
  - contributions to an approved occupational pension scheme in respect of which the individual was entitled to tax relief as an expense
  - contributions under an approved payroll giving scheme.

The £8,500 limit applied to all remuneration received in the appropriate tax year, together with all expense payments made to the employee and benefits provided for him or her. This included private medical or other health or welfare benefits provided by an employer.

Employees earning less than £8,500 p.a. were exempt from these special provisions but may have faced liability to income tax based on other specific charging provisions relating to non-cash benefits (for example vouchers, share options and non-representative living accommodation). In addition, where a non-cash benefit was capable of being exchanged for or turned into cash, these lower paid employees faced an income tax charge based on the secondhand value, if any, of the item provided.

However, following a recommendation of the Office of Tax Simplification, legislation was introduced that abolished the £8,500 threshold from 6 April 2016, but with a specific exemption for ministers of religion.

Other changes in the taxation of expenses and benefits in kind that employers give to their employees taking effect from 6 April 2016 were:

- voluntary 'payrolling' of benefits in kind; and
- replacing dispensations with an exemption for paid or reimbursed expenses.

<https://www.gov.uk/browse/business/expenses-employee-benefits>.

### **2.6.1 Benefits Provided for the Family or Household of an Employee**

When an employer makes expenses payments to an employee or provides benefits for an employee or members of the employee's family or household they are deemed to have been made or provided by reason of that employment – they are regarded as part of the reward for the job.

Subject to minor exceptions any benefit provided for the members of the family or household of an employee ranks as if it were provided for the employee personally.

### **2.6.2 Tax Efficiency of Benefits**

A tax efficient benefit is one for which the tax payable on the cost of providing the benefit is less than the tax that would be payable by the employer and employee on the equivalent cash sum. In the past, tax efficiency was one of the main reasons for the proliferation of benefits, but it has become progressively less important as Governments have tightened up the fiscal rules relating to employee benefits.

The tax considerations affecting benefits are very important from the point of view of reward management policies and practices. They need, however, to be considered within the context of the general provisions of tax law.

As far as employment earnings are concerned, a nearly level playing field between cash salary and benefits has been created. As a result, many of the tax privileged benefits of the past have gone – cheap mortgages for bank and insurance company employees are a prime example.

### **2.6.3 Tax Treatment of Benefits in Kind**

Where an employee receives a benefit, such as medical insurance or critical illness cover, they will still be taxed on the value of that benefit but may not pay employee's National Insurance Contributions. However, not all benefits are subject to tax in this way; pensions, life assurance and additional holiday are examples.

### *Types of taxable benefits:*

- the provision of living or other accommodation, including light, heat, council tax and domestic or other services
- the use of any asset provided by the employer or another person acting on the employer's behalf, for example the use of a motorcycle, equipment or of furniture or a TV set
- fuel for private motoring in a company provided car
- gifts of assets to the employee, or the sale to the employee of assets at less than their market value (this applies not only to assets such as a car or a house, but also to goods such as clothes, TV sets, wine, or groceries)
- income tax not deducted from remuneration paid to a director, but paid to HMRC by the employer and not reimbursed by the director
- scholarships awarded to students by reason of their parents' employment
- any other benefits or facilities of any kind, for example hotel accommodation and restaurant facilities arranged by the employer, holidays, childcare (some forms of childcare are exempt), sporting facilities (some sporting facilities are exempt), and work carried out at the employee's residence.

### Types of expenses payments and benefits not normally taxable:

- office accommodation, supplies or services
- equipment provided for disabled employees
- meals and food vouchers
- expenses incurred in the provision of pensions on retirement or death
- medical treatment abroad
- nurseries or play schemes
- job related living accommodation
- payment towards additional household costs incurred by employees who work at home
- some travelling expenses (excluding home to work travel)
- re-training expenses and courses
- long service and suggestion scheme awards
- parking spaces
- goodwill gifts
- only for people who work primarily at home, travel between home and employers' premises
- annual parties or similar functions costing no more than £150 per head
- sports facilities not available to the general public
- mobile telephones provided by an employer
- cost of purchasing assets from employees
- work related training expenses
- welfare counselling
- removals expenses and benefits
- any expenses or liabilities incurred by the employee and paid direct by the employer, for example hotel or restaurant bills, whether paid direct or through a credit card company.

### **2.6.4 Provision of Living Accommodation**

Employees who are provided with living accommodation by their employer will be subject to tax on the "annual value" of the property, which is generally taken to be its gross rateable value. Where an employee is provided with a new property (or one that has been significantly altered) it may not be possible to obtain a rateable value. This is because domestic rating lists are no longer being maintained following the introduction first of the community charge and now of the council tax. In such circumstances employers are required to provide an estimate of what the gross annual value would have been if rates had continued. The tax office will then agree such estimates with assistance from the local District Valuer's office.

Where the accommodation costs the employer more than £75,000 an additional charge based on the official rate of interest as at the commencement of the tax year is payable on the excess.

No liability arises when the employee is in “representative occupation”. This is defined as:

- residence necessary for the proper performance of employment duties
- accommodation provided for better performance of duties where this is customary in the type of employment
- accommodation provided as a special security measure.

### **2.6.5 Long Service Awards**

Long service awards are tax free for all employees, provided that the following conditions are met:

- the award must not be cash but a tangible article
- the cost to the employer must be no more than £50 for each year of the employee’s service
- the period of service with the same employer before the award is made must be at least 20 years
- such awards must not be made more frequently than once every ten years to a particular employee

Care must now be taken with long service awards. The value of the awards must not be “disproportionate” otherwise they may fall foul of the Age Discrimination Legislation.

### **2.6.6 Canteen, Sports, and Social Facilities**

If facilities are provided for employees generally, there is no tax charge.

Otherwise, unless there an exemption applies, employers must:

- report the cost on form P11D for each employee using the facilities; and
- pay Class 1A National Insurance on the value of the benefit - this is normally the cost of providing the facilities.

### **2.6.7 Measures of Relevance to Benefits in Kind**

The Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) contains most of the provisions related to benefits in kind.

In ITEPA 2003 income tax is chargeable on employment income that includes:

- earnings – salary, wages, fees and other emoluments
- amounts treated as earnings – including benefits
- amounts which are not earnings but count as employment income.

### **2.6.8 Counselling Services for Employees**

There is an exception to taxation on certain benefits in circumstances where counselling or treatment relates directly to an event that has occurred in the process of carrying out the duties of the employment.

In practice, however, where counselling services are available to employees generally, the assessable benefit per employee can be very small and tax may not be charged.

No income tax charge arises on reasonable outplacement counselling services provided by an employer for employees whose contracts of employment have been terminated.

The exemption applies not only to payments that the employer makes for the counselling itself but also to payments of any other associated fees and travelling expenses necessarily incurred in connection with the provision of the counselling.



### 2.6.9 Counselling Exemption

Under ITEPA 2003 welfare counselling provided to an employer's employees generally is exempt from tax on employment income.

Welfare counselling means counselling of any kind apart from:

- medical treatment of any kind, or
- advice on finance, other than advice on debt problems, or
- advice on tax, or
- advice on leisure or recreation, or
- legal advice.

If the counselling provided includes any of these, the exemption does not apply. Care must be taken to ensure that Employee Assistance Programmes (EAP) do not fall foul of these rules.

#### *Outplacement*

The other type of counselling that is exempt from tax is that relating to outplacement. Where an employee is made redundant, his or her employer may pay for the employee to receive professional advice and assistance designed to help in coping with the new situation and to find a new job. Such professional advice is known as outplacement counselling and may consist of anything from a single advisory interview to ongoing assistance or advice for a period of several months.

It has become an increasingly common feature of redundancy packages offered by employers in recent years. Where it is provided, on an individual basis, to an employee, the payment made by the employer is "on behalf of" the employee and falls within the charge to tax under ITEPA 2003.

### 2.6.10 Payments on Termination of Employment

New rules for the taxation of termination payments were announced in 2018.

The changes align the rules for tax and secondary National Insurance contributions (employer (NICs)) by making an employer liable to pay NICs on termination payments they make to their employees. An employer will be required to pay NICs on any part of a termination payment that exceeds the £30,000 tax-free threshold. It is anticipated that this will be collected in 'real-time', as part of the employer's standard weekly or monthly payroll returns and remittances to HMRC.

Measures also clarify the scope of the exemption for termination payments through a number of changes. All payments in lieu of notice (PILONs) will be both taxable and subject to Class 1 NICs. The legislation requires the employer to identify the amount of basic pay that the employee would have received if they had worked their notice period, even if the employee leaves the employment part way through their notice period. The amount will be treated as earnings and will not be subject to the £30,000 Income Tax exemption. All other termination payments will be included within the scope of the £30,000 termination payments exemption.

Further information is provided in a policy paper at – Income Tax and National Insurance contributions: treatment of termination payments - GOV.UK ([www.gov.uk](http://www.gov.uk)).

### 2.6.11 Annual Information to HM Revenue & Customs (HMRC)

Employers that provide expenses or benefits to employees or directors may need to tell HMRC and pay tax and National Insurance on them.

There are different rules for what has to be reported and paid depending on the type of expense or benefit that employers provide.

### 2.6.12 A-Z of benefits and changes to the taxation of expenses and benefits in kind

Helpfully, an A-to-Z list of expenses and benefits is available on the HMRC website - <https://www.gov.uk/expenses-and-benefits-a-to-z>.

### 2.7 PENSION BENEFIT IMPLICATIONS

Despite recent tightening of the fiscal rules relating to employee benefits, pension schemes are still tax efficient for most employees.

Contributions to a registered pension scheme are not regarded as benefits in kind for tax purposes. Both the employer and the employee get tax relief on contributions made to a registered occupational pension scheme. This is subject to the limits introduced in the 2004 Finance Act, as amended.

From 6 April 2011, the annual allowance (AA) was significantly reduced to £50,000 and defined benefit pension accrual is valued using a flat factor of 16 for testing against the AA. Within the reduced AA, tax relief will still be given at the individual's marginal tax rate.

From 6 April 2012, the Lifetime Allowance (LTA) was reduced from £1.8 million to £1.5 million. From 6 April 2014, the AA and LTA are further reduced to £40,000 and £1.25 million respectively.

From 6 April 2016, the LTA was reduced again to £1 million. However, in April 2018, it increased in line with inflation to £1,030,000, in April 2019 it was increased to £1,055,000 and in April 2020 it was increased to £1,073,100.

In The Finance Act 2021, the Government announced that the level of the lifetime allowance would remain frozen at its current rate of £1,073,100 until April 2026.

The lifetime allowance, the maximum amount someone can accrue in a registered pension scheme in a tax efficient manner over their lifetime, will be abolished entirely from 6th April 2024. Prior to that, the lifetime allowance charge was removed from 6th April 2023. (Finance Act 2023).

From 6 April 2016, a tapered AA was introduced for individuals deemed to be the highest earners by HMRC. If someone's taxable income from all sources in any tax year exceeds £110,000 (referred to as Threshold Income), the £40,000 AA will be reduced by £1 for every £2 of Adjusted Income" in excess of £150,000. The AA cannot fall below £10,000. Therefore, those with adjusted earnings of £210,000 or more will be subject to a minimum AA of £10,000.

- Adjusted Income is, broadly speaking, your income plus pension savings.
- Threshold Income is, broadly speaking, your income plus the amount of any employment income given up for pension provision as a result of salary sacrifice made on or after 9 July 2015.

Changes were made to the taper from April 2020. Following a review by HM Treasury on its impact on the NHS, as well as on public service delivery more widely, it was decided that the two tapered annual allowance thresholds would each be raised by £90,000. This means that from 2020-21 the "threshold income" will be £200,000, so individuals with income below this level will not be affected by the tapered annual allowance, and the annual allowance will only begin to taper down for individuals who also have an "adjusted income" (income including the value of pension contributions / benefits) above £240,000.

For those on the very highest incomes, the minimum level to which the annual allowance can taper down will reduce from £10,000 to £4,000 from April 2020. This reduction will only affect individuals with total income (including pension accrual) over £300,000. These figures are still correct for the 2022/23 financial year.

The Finance Act 2023 again raised the adjusted income to £260,000 from 6/04/2023. So those earning below this will not have their AA tapered down. The tapering also stops for those earning £360,000 or more. So, everyone will retain an allowance of at least £10,000. The minimum allowance rose to £10,000 from £4,000 on 6/04/2023 following the Finance Act 2023. For example, if your income was £280,000 your AA would be £50,000. As the AA is reduced by £1 for every £2 of income over £260,000 via tapering.

The AA has been increased from £40,000 to £60,000 from 6/4/2023 following the Finance Act 2023. This means that if a member has exceeded the Annual Allowance this will be added to the rest of their taxable income for the tax year and be subject to Income Tax at their marginal rate.

Further information on the tax regime for registered pension schemes is covered in the core units.

### **2.7.1 Ex gratia Payments**

HMRC normally regards ex gratia payments made on retirement or death as falling within the normal pension scheme tax rules. Such payments are therefore taxable except lump sum payments from a registered pension scheme that, provided they are within the prescribed limits, are tax free.

### **2.7.2 Christmas Bonus payments to Pensioners**

Pre-6 April 2006 or A-Day, an approved retirement benefits scheme could only provide relevant benefits. The definition of relevant benefits was contained in s612 (1) of ICTA 1988 and referred only to benefits in the form of cash. On the other hand, unapproved retirement benefits schemes were able to provide benefits “consisting of or including relevant benefits”.

From A-Day, the Finance Act 2004 changed the classification of pension arrangements and the rules governing the benefits provided to members. Under the Finance Act 2004 approved retirement benefits schemes became registered schemes and unapproved retirement benefits schemes became employer financed retirement benefit schemes.

As mentioned, there were also changes to the taxable benefits which could be provided to a member. Before A-Day taxable benefits to pensioners included Christmas bonuses paid in cash form only from an approved scheme or from an unapproved scheme. There were no issues over the frequency of the payment of such bonuses.

However, from A-Day the rules regarding Christmas bonuses changed. From A-Day, if the payment of a Christmas bonus is compulsory (i.e., in the scheme rules) and occurs on an annual basis it might fall within the definition of “scheme pension” (either as part of the main pension or as a separate scheme pension, payable annually in December), and therefore an authorised payment under the Finance Act 2004 tax regime. It would need to be included in any test against the lifetime allowance (i.e., added to the member’s “normal” pension in determining the amount of the lifetime allowance used up when the member retires). It would also be subject to other requirements; in particular LPI increases, if it is regarded as “post-97”, which would clearly cause problems if the bonus is a fixed amount.

If the payments are on a discretionary basis there are other potential problems. In order to be authorised, they would have to meet the requirements for a scheme pension. It is not possible to reduce a pension from one year to the next except in specific circumstances, for example ill health retirements or where the reduction applies to all pensions being paid. Companies may therefore decide to pay such bonuses directly to pensioners, outside the pension scheme.

Other benefits which may be given to pensioners include Christmas hampers, lunches etc.

### Summary

Total remuneration (or benefit) is the value of all cash payments and benefits received by an employee. It is a way of quantifying the entire benefits package which an employee receives on an annual basis.

Adopting a total benefits strategy approach helps raise the awareness and understanding, including the value, of each element of the overall reward package. Benefits can be valued in a number of ways – namely using the cost to the employer or using the cost to the employee.

A total benefits strategy should be developed taking a wide range of factors into account. The strategy should also be measured and evaluated. Furthermore total benefits should be carefully and comprehensively communicated.

### Self Test Questions

- What would be the tax treatment of benefits in kind for an employee's family?
- Explain the tax treatment of counselling services offered to employees.
- Outline the different ways to value benefits.
- What are the normal phases of implementing a flex plan?
- Outline the methods that can be used to communicate employee benefits.
- What would a total reward statement typically include? Consider the benefits provided by your own organisation; how could they be illustrated in a total reward statement?
- What are the factors which should be taken into account when developing an employee benefits strategy?

## PART 2

# HEALTH AND RISK BENEFITS

### OVERVIEW

Apart from pay, health and risk benefits are fast becoming some of the most important benefits in any employee's benefit package. Employees are becoming increasingly concerned that not only do they have the money to allow them to pay their bills and mortgages etc., but that they also have the means to ensure that if they become sick their finances are covered as well as ensuring that their families are cared for in the event of death or permanent sickness.

Chapter 1 looks at the benefits that exist for employees who become absent from work due to illness or injury. The Chapter details the benefits that are available in such instances and includes: supporting income from the State (e.g., statutory sick pay), supporting income from the employer (e.g. income protection insured schemes, the employers own sick pay policy) and income from the pension scheme (e.g. ill health early retirement).

Chapter 2 looks at healthcare in general, critical illness and personal accident schemes. It discusses the various aspects of private medical insurance, how it interacts with the NHS and the tax implications. The Chapter also looks at critical illness schemes which bridge the gap between death benefits and income protection schemes and provide support to employees and their families where an individual has been diagnosed with a critical illness, such as a heart attack or cancer.

It is important that students are aware of and understand the different benefits that are provided by the State and how these interact with and impinge on benefits provided by private arrangements (occupational pension schemes, private medical arrangements, and group income protection schemes).

After studying this section, students will be conversant with what income protection benefits are provided by the State and which are provided on a privately arranged basis. The student will also understand the structure, costing and taxation bases of income protection, private medical and critical illness arrangements.

# CHAPTER 1

## Income Protection (IP) Schemes

### INTRODUCTION

Employers vary widely in the way they choose to make provision for employees who become unable to work for a period due to sickness or accident.

This Chapter will consider the relationship between benefits payable by the State in the event of short- and long-term incapacity and those provided either directly or as insured benefits by employers.

In this Chapter, we also touch on the proposed State benefits payable during an employee's sickness absence. More detail is available either by obtaining leaflets from your nearest benefit agency office or on the Gov.UK website at <https://www.gov.uk/browse/working/time-off>.

All monetary values quoted are the relevant rates for the tax year 2023/2024 and are the latest figures available at the time of going to press.

### 1.1 STATE SICKNESS BENEFITS

#### 1.1.1 Statutory Sick Pay (SSP)

When an employee is unable to work due to sickness or disability, employers must make payments for time off sick to at least a minimum level. Therefore, during the first 28 weeks of time off work employers must, as a minimum, make statutory payments.

SSP is payable at a flat rate of £109.40 per week irrespective of the employee's income. SSP is only payable after the employee has been off work sick for at least four consecutive days (including weekends and holidays). SSP is paid through the employer's payroll and any liability for income tax and/or National Insurance contributions is deducted at source in the usual way. The employer will normally pay the employee in the same way and on the same day that the employee would normally receive his or her wages. SSP is not a means tested benefit.

To be eligible for SSP the employee must earn at least enough to pay Class 1 National Insurance contributions – the earnings threshold of £123 per week. If the earnings threshold is not met then income support may be claimed, although this is a means tested benefit. SSP is limited to a maximum payment period of 28 weeks, but different periods of sickness may be linked for this purpose if they are at least four days in a row and less than eight weeks apart. If sickness/disability continues after the end of the 28-week period then incapacity benefit may be claimed.

#### 1.1.2 Incapacity Benefit

Incapacity Benefit is being replaced with Employment and Support Allowance (ESA) – see section 1.1.3.

An individual will be reassessed if they are already claiming Incapacity Benefit, to decide if they are capable of work or eligible for ESA. An individual will not be reassessed, however, if they are close to State Pension age.

#### 1.1.3 Employment and Support Allowance (ESA)

ESA replaced all incapacity benefits for all new claimants with effect from 27 October 2008. Employees will continue to receive SSP for the first 28 weeks of absence. For those not eligible for SSP (e.g., the self-employed), ESA will commence in place of SSP following four consecutive days of illness.

At the end of the 28-week period of SSP, there will be a 13-week assessment period which, in addition to using means testing or a claimant's National Insurance contribution history to establish eligibility, will require the claimant to demonstrate the extent to which their illness or disability prevents them from working. This "assessment phase", also known as the Work Capability Assessment (WCA) replaces what was previously known as the "Personal Capability Assessment" (PCA).

During the assessment phase, an employee will receive a benefit broadly equivalent to jobseeker's allowance. The current weekly figures as at 2023/24 are £67.20 for a single person aged between 16 and 24 and £84.80 for a single person above age 25.

Throughout the assessment phase, the claimant will be invited to attend several work-focused interviews with a personal adviser. The outcome of these interviews will be to establish one of three possible results at the end of the assessment phase:

1. the claimant has a limited capability for work (those that can be rehabilitated back into the workplace)
2. the claimant has a limited capability for a work-related activity (the most severely incapacitated who realistically are not expected to return to work)
3. the claimant does not qualify for benefit (and benefit will cease).

It is possible to extend the assessment phase beyond 13 weeks in certain circumstances, e.g., if the claimant is too ill to attend an examination. In such cases, the claimant will continue to receive the initial rate of benefit but once they have been assessed the "main phase" rate of benefit will be backdated.

If entitled to ESA, a claimant will be placed in one of 2 groups and will receive in 2023/24:

1. up to £84.80 a week if in the work-related activity group
2. up to £129.50 a week if in the support group.

A claimant might get more ESA in the work-related activity group if they applied before 3 April 2017.

If in the support group and on income-related ESA, in 2023/24 the claimant is also entitled to the enhanced disability premium at £19.55 a week if single, or £27.90pw for a couple.

They may also qualify for the severe disability premium in 2023/24 at £76.40 per week if single or couple at the lower rate or £152.80 pw for a couple at the higher rate.

Special rules were introduced for those affected by Covid - Employment and Support Allowance (ESA): Eligibility - GOV.UK ([www.gov.uk](http://www.gov.uk)).

### 11.4 Other State Benefits

The following may also apply:

#### *Severe Disablement Allowance*

Severe Disablement Allowance has also been replaced with Employment and Support Allowance. Job Centre Plus will re-assess an individual's Severe Disablement Allowance claim to see if they are capable of work or eligible for ESA. A claim won't be re-assessed if an individual reaches State Pension age before 6 April 2014.

This tax-free benefit could be claimed after 28 weeks if the claimant was not eligible for incapacity benefit due to not having paid sufficient National Insurance Contributions. Dependency additions are payable in respect of a spouse or for someone looking after any children. Severe disablement allowance is not in any way an income related benefit.

### *The Working Tax Credit*

Following the replacement of the disability working allowance with the disabled person's tax credit from 5 October 1999, the latter was in turn replaced by the working tax credit from 6 April 2003. This benefit is administered and paid by HMRC and is settled by employers through the payroll. This will cease as all claimants are moved to Universal Credit by the end of 2024.

The Working Tax Credit is designed to help those, whether employed or self-employed, who:

- are aged 25 or over and do paid work at least 30 hours a week
- have a disability and are age 16 or over and do paid work at least 16 hours a week
- are aged 60 or over and do paid work at least 16 hours a week
- if single and responsible for children, do paid work at least 16 hours a week
- if a couple and responsible for children, jointly do paid work at least 24 hours a week with one of the couple doing paid work at least 16 hours a week.

The purpose of the Working Tax Credit is to support working households with limited incomes by topping up their earnings. The Tax Credit is made up of a number of elements depending upon the claimant's circumstances and includes extra elements for those who are working and have a disability.

The amount of Working Tax Credit will depend on the annual income received from the previous April to April. The disabled worker element varies depending on the severity of disablement. To be entitled to the Working Tax Credit the individual must work for at least the number of hours listed above, which vary depending on their circumstances.

The claimant may receive the disability element of the Working Tax Credit if they not only work at least 16 hours a week but also have a physical or mental disability which puts them at a disadvantage of getting a job and satisfy certain qualifying benefit tests.

Details of disabilities are stated in the guidance prepared by HMRC are such as to put someone at a disadvantage in getting a job and include difficulty in seeing or hearing, difficulty in communicating with people, and mobility related issues.

In order to satisfy the necessary requirements to qualify the claimant must be receiving any one of the disability living allowance, attendance allowance, or attendance allowances associated with industrial injury disablement benefit or war disablement pension. Alternatively, the claimant must have received any of incapacity benefit at the short term higher rate or the long term rate, income based jobseekers allowance, income support, or severe disablement allowance.

### *Disability Living Allowance*

Disability living allowance is designed for those who because of illness and disability need help with personal care, supervision, or need someone to care for them because of physical or mental disability, or because they are unable to walk or have difficulty in walking or need someone to be with them when walking outdoors. It also covers those who have both care and mobility needs. These needs need to have developed before the age of 65 resulting in the claimants being too young to claim Attendance allowance.

Existing claimants on Disability Living Allowance, and who are not claiming any other disability benefit will not be required to attend a work-focused interview.

Personal Independence Payment is gradually replacing Disability Living Allowance. Details of this new benefit and the transition can be found at - <https://www.gov.uk/pip>.



### *Industrial Injuries Disablement Benefit*

Entitlement for this benefit, otherwise known as “the disablement pension”, is for those that have become disabled as a result of an accident or the contraction of a prescribed industrial disease during employment. This benefit is not means tested and there is no consideration of the claimant’s National Insurance contribution record. This benefit is not available to the self-employed. The amount of benefit payable depends upon the extent of disablement as a consequence of the accident or prescribed disease. An assessment is undertaken by an independent adjudicating authority. The maximum rate of benefit is £182.90 per week (2022/23).

### *Income Support*

The purpose of income support is to top up the income of those whose income from all sources is below a minimum threshold level set by Government. Any joint income is halved to determine the applicant’s share. State pensions are however allocated to the persons that are entitled to receive them, so a spouse’s State pension derived from the partner’s contributions belongs to the spouse.

In relation to disablement, the claimant must be aged between 16 and 60 and must satisfy one or more of the following categories:

- unable to work because of sickness
- caring for a severely disabled person or family member who is ill
- a disabled person where earnings are reduced because of disability
- the claimant is employed but living in a residential care home or nursing home
- the claimant is a disabled or deaf student
- the claimant is a blind person.

Eligibility for income support is normally lost where the claimant on average works 16 hours or more per week or if their partner works an average of more than 24 hours per week. However, there are certain exemptions to this “remunerative work” where for example if due to a mental or physical disability the claimant is only able to earn 75% or less of what he would have earned had he not been disabled. This is a complex benefit with a number of possible elements as the intention is to fill the gap between the claimant’s needs and their income. Other income and capital may affect the assessed sum. Savings over £16,000 usually mean the claimant cannot get Income Support.

Those going into residential care or nursing homes get normal Income Support or the Pension Credit, (if over age 60). For those over the age of 60 income support was known as the Minimum Income Guarantee (MIG). The MIG was, from 6 October 2003, replaced by a new entitlement called the Pension Credit.

### *Pension Credit*

On 6 October 2003, Income Support for people over 60, including care home residents, was replaced by a new benefit – the Pension Credit. Pension Credit is administered by the Pension Service which is part of the Department for Work and Pensions (DWP). People aged 60 and over who were already receiving Income Support in October 2003 were transferred automatically to Pension Credit without having to make a new claim. Pension Credit is not taxable.

Pension Credit had two parts: the “guarantee credit” and the “savings credit”. The guarantee credit is very similar to the previous Income Support (Minimum Income Guarantee) system for people aged over state pension age. For a couple both must be over state pension age. It can top up the claimants’ income to £182.60 for single people and £278.70 for a couple (2022/23). The savings credit provided extra incomes for those aged 65 and over that have only modest savings, investments, and income. In 2022/23 it is £14.48pw extra for a single person and £16.20pw for a couple. The savings credit element of Pension Credit was abolished following the introduction of the new single tier State pension from 6 April 2016, but only for those reaching State pension age from that date.

Pension credits are an extremely complex benefit to understand and depends on many individual circumstances. For further information see the range of DWP leaflets available from the Post Office and of course the local Benefits agency office. Information is also available from the DWP or Gov.UK website at: <https://www.gov.uk/pension-credit>.

Another useful source of information is available through the comprehensive series of fact sheets that are published by Age UK. These can be accessed at [www.ageuk.org.uk](http://www.ageuk.org.uk)

### *Universal Credit*

Universal Credit is set to replace all benefits by the end of 2024.

A person may be able to claim if they are on a low income or out of work.

Universal Credit is replacing:

- Jobseeker's Allowance
- Housing Benefit
- Working Tax Credit
- Child Tax Credit
- Employment and Support Allowance
- Income Support

### *The benefit cap*

There's a limit on the total amount of benefit that most people aged 16 to 64 can get. This is called the benefit cap.

The cap applies to the total amount people in a household (the claimant, their partner and any children living with the claimant) get from the following benefits:

- Bereavement Allowance
- Child Benefit
- Child Tax Credit
- Employment and Support Allowance (unless you get the 'support' component)
- Housing Benefit
- Incapacity Benefit
- Income Support
- Jobseeker's Allowance
- Maternity Allowance
- Severe Disablement Allowance
- Widowed Parent's Allowance (or Widowed Mother's Allowance or Widows Pension if you started getting it before 9 April 2001)
- Universal Credit (unless you've had a work capability assessment and aren't fit for work).

A claimant is not affected by the cap if anyone in their household qualifies for Working Tax Credit or gets any of the following benefits:

- Armed Forces Compensation Scheme
- Armed Forces Independence Payment
- Attendance Allowance
- Carer's Allowance
- Disability Living Allowance (DLA)
- Employment and Support Allowance (if getting the support component)
- Guardian's Allowance

- Industrial Injuries Benefits (and equivalent payments as part of a War Disablement Pension or the Armed Forces Compensation Scheme)
- Personal Independence Payment (PIP)
- Universal Credit payments towards carers' costs or for 'limited capability for work and work-related activity'
- War pensions
- War Widow's or War Widower's Pension.

From autumn 2016 the cap depends on where someone lives in the UK. Current cap levels are at - [https:// www.gov.uk/benefit-cap/benefit-cap-amounts](https://www.gov.uk/benefit-cap/benefit-cap-amounts).

### 1.2 DISABILITY BENEFITS – EMPLOYER PROVISION

It is anticipated that State benefits will be smaller and harder to obtain following the Government's reforms. Along with the recent legislation contained in the Disability Discrimination Act, under which an employer must make "reasonable adjustments" to enable a disabled employee to continue working, a greater focus is being placed upon employers playing a bigger part in helping their employees return to work. Early intervention is generally proven to achieve more effective results, thereby resulting in the most positive outcome for all parties.

#### 1.2.1 Short Term Employer Provision

Most employers pay more than the minimum statutory sick pay and may pay an employee his normal earnings for a period, the length of which may be service related, being increasingly generous with increased service.

Short term provision from employers is often non-insured, in effect self-insured, and the period should ideally dovetail with longer term provision as described below.

Alternatively, earnings could be payable in full for a period followed by a period of half pay before any long-term arrangements cut in.

In addition, some employers operate personal accident schemes for their staff which may include provision for short-term sickness benefits. Generally, such schemes provide for a lump sum payment in the event of death by accident, with scaled down benefits payable, for example, on the loss of one or more limbs or eyes as the result of an accident. Total and permanent disablement as the consequence of an accident is also covered, again by payment of a lump sum. In the event of temporary total disablement following an accident (and, depending on the scheme, sickness may be included here), an income benefit is payable with the maximum term of payment usually being limited to 104 weeks.

Personal accident schemes are considered separately in Chapter 2.

#### 1.2.2 Disability Benefits – Long Term Employer Provision

The provision of long-term benefits in the event of long-term disability may be made by employers through long term disability arrangements generally known as Income Protection (IP) benefits. These may or may not be insured through an IP insurance policy.

IP benefits may be provided for all employees or perhaps just for certain categories of employee, e.g., senior executives or managers.

The design of such arrangements should take account of a number of factors including:

- an appropriate linkage with short term benefit provision, from employer and the State, and longer-term State help
- a linkage with any available provision for retirement on the grounds of incapacity under any occupational pension scheme that may be in place
- where there is no prospect of a return to work, a link with provision post-retirement (i.e., a pension).

### 1.3 IP INSURANCE ARRANGEMENTS

Group IP benefit arrangements are operated by many employers, and usually without cost to the employee. The purpose is to cater for the income needs of employees who suffer long term disability. There should be a link to the employee's contract of employment so that the employer continues to pay salary at the full or a reduced rate for an initial period before the group IP benefit commences.

As IP arrangements are for the purpose of covering long-term disability it is usual for there to be a waiting period before benefit is payable in the event of a claim. Typically, a waiting period (or deferred period) of 26 weeks might be chosen as a suitable scheme design but schemes may, alternatively, be set up with waiting periods of 13, 28, 52, or 104 weeks. The chosen waiting period should ideally link in with short-term provision so that there is continuous coverage of income for the employee. Employers may also wish to consider a waiting period of 41 weeks in the future to tie in with the end of the assessment phase of the new ESA.

Generally, the benefit payable will link with long-term State provision whilst maintaining at least some financial incentive to return to work.

The level of benefit is specified as a percentage of gross or net pre-incapacity earnings, as outlined below.

- **Gross Pay Policy** – Benefits are specified as a percentage of gross pre-incapacity earnings. The normal maximum benefit that can be insured for each employee is 75% of pre-incapacity earnings, less the basic long-term rate of the State Incapacity Benefit payable to a single person. With “State Incapacity Benefit” being replaced by ESA at the Work-Related Activity Component level (WRAC), the maximum benefit that can be insured for each employee can be increased to 80% (with no “offset” for State benefits), by most insurers.
- **Net Pay Policy** – Benefits are specified as a percentage of net pre-incapacity earnings. The normal maximum benefit you can insure is 90% of net pre-incapacity earnings after taking into account any State Incapacity Benefit (or ESA-WRAC) actually received. Insurers no longer offer this for new business but continue to cover existing arrangements.

Under normal circumstances benefit under the IP arrangement for an employee normally ends:

- when they leave company employment or are no longer eligible to be a member
- when they reach the benefit termination date under the IP scheme which will normally coincide with State pensionable age or the normal retirement age under any pension scheme of the employer if different
- if they retire early
- if they die
- if they make a full return to work
- if they cease to meet the definition of incapacity.

In addition to the income protection benefit described above, the arrangement might also make provision for the continuance of both employer and/or employee pension scheme contributions, thus enabling the linkage with post-retirement. The liability to pay National Insurance contributions on the member's benefit can also be insured.

Each insurer will set a maximum benefit formula on the policy, and this is determined at the beginning of the policy.

### 1.3.1 Exclusions

Under most policies there may be a range of circumstances under which a claim will not be met. Exclusions for claims arising from certain specified medical conditions or in specified circumstances may be imposed on a specific member's benefits as part of the medical underwriting process.

The deferred period must be completed, and all other policy terms and conditions will need to be satisfied before benefit is payable.

### 1.3.2 Design Features of IP Arrangements

IP arrangements are provided to protect an employee's income should they need to take time off work for sickness. This type of benefit can be supported from the employer (e.g., through a company paid income protection insured scheme). The design features of an insured scheme are as follows:

- The conditions of covering entry into the policy must be selected. An employee can become a member if they satisfy the conditions of eligibility defined in the IP policy and meet the definition of being actively at work.
- A proportionate benefit is payable if a part-time return to work is possible or if it becomes possible for a lower paid job to be taken.
- Employers may choose to increase any benefits that are being paid to protect against inflation or to keep benefit payments level. The percentage rate of annual increases can be 3% p.a., 5% p.a., or in line with the Retail Prices Index (to a maximum of 2.5% or 5%).
- Depending on the size of the scheme membership a level of medical evidence free cover will be available known as the free cover limit (FCL).
- The payment of IP benefit under an IP benefit arrangement can be provided up until normal retirement age, or a specific limited period of two, three or five years can normally be selected.
- Payment is normally made to the employer and administered through the payroll system, though some insurers will allow "pay direct".
- It may be possible to insure a lump sum at the end of a limited benefit payment term, provide the claimant still meets the definition of incapacity, e.g. a lump sum equivalent to the pension contributions that would have been paid for that employee to retirement age. This could then be paid into the employee's pension pot, providing them with an income in retirement.
- Incapacity or disability can be defined in different ways according to the types of illness, injury and circumstance the policy covers. This can be described as either "own-occupation", "suited-occupation", or a combination of both, e.g., own occupation for 24 months and suited occupation thereafter. A claim will be paid if the ill or injured employee meets the definition of incapacity that is selected under the policy.

### 1.3.3 Costing

The premiums charged for a particular arrangement depend on a number of factors. These include the age, sex, occupation, and locations of the employees to be covered, as well as the actual benefits being provided, the termination age and the length of the chosen deferred period.

Costing is very similar in nature to Group Life business. It will either be calculated on a single premium basis to cover each year, effectively aggregating the premiums attributable to each individual based upon their age and gender, or on a unit rate basis. Under the latter method a rate applicable to the entire arrangement is calculated based on the variables already described above.

The unit rate method is accounted for using simplified administration. This means that an annual rate of premium applicable to all members (referred to as the Unit Rate or Flat Rate) is calculated at the start of the guarantee period. Unit rates are usually guaranteed for two years and are subject to review thereafter. New rates may apply at the end of this period.

Consequently, details of individual employees who join or leave mid-year are not required; the only information required at a mid-rate guarantee policy accounting date is the total number of members and total salary roll or total benefit roll at that date. Individual details are required only for any members whose benefits exceed the FCL or who are joining outside the normal eligibility conditions of the policy (e.g., late entrants).

However, the insurer may wish to review the unit rate or terms of the policy from time to time throughout the guarantee period, for example if the number of lives insured under the policy significantly changes (e.g., an acquisition, merger, or redundancy exercise).

### 1.4 TAXATION OF BENEFITS AND CONTRIBUTIONS

The whole cost of a standard IP policy is usually met by the employer.

#### *Income Benefit*

Income benefit is payable to the employer who passes it on to a claimant as a salary continuance. For tax purposes, premiums are treated as an allowable business expense; income benefit received is a taxable receipt and payments passed on as salary are an allowable expense, giving a neutral tax situation.

Income benefit received by the employee as salary is taxed as PAYE.

#### *Premiums*

Premiums are not treated as a taxable benefit for employees. However, if the arrangement includes controlling directors and the employer is a director-controlled company then the premiums attributable to the directors will be disallowed for relief if the benefits being provided for the directors are materially different to those being provided for at least some of the other employees. If the employer is a partnership, however, partners may be included in a group scheme but there will not be any tax relief on their premiums.

HM Revenue & Customs does not normally grant tax relief on premiums paid for any employees with a proprietary interest in the company. However, they may sometimes grant tax relief provided that a substantial number of other employees are entitled to similar benefits. Employees themselves or the self-employed may take out an individual IP policy and there will be no tax relief available.

This guide to the tax treatment of income protection benefits and premiums are based on an understanding of current law and HMRC practice, which is subject to change. Policyholders should take advice from their own professional advisers to ensure that they understand the impact of tax and legislation.

### 1.5 ILL HEALTH RETIREMENT OPTIONS FROM THE PENSION SCHEME

It is common for occupational pension scheme rules to contain a provision for the immediate payment of pension, regardless of age, on the grounds of incapacity.

This tends to cover the situation where a pension scheme member has suffered mental or physical deterioration that prevents them fulfilling their normal employment or which seriously impairs their earnings ability. It should be noted that a mere decline in ability or energy is not sufficient justification for this purpose.

Employers and Trustees will define the benefits payable under this rule. The benefits provided can vary from the accrued value paid early (with or without a reduction factor for early payment) up to the maximum that would have been permitted from the scheme at Normal Retirement Date based upon full prospective service. Some schemes will have different levels of pension payable depending upon the severity of the incapacity.

Where retirement is on the grounds that expectation of life is very short (no more than 12 months) full commutation for cash is allowable by HMRC with the exception of dependants' pensions which will become payable in the usual way. Such a lump sum is tested against any of the members' Lifetime Allowances and, to the extent that there is any excess, chargeable to tax at 55%. However, up to the Lifetime Allowance, it is tax-free.

In all circumstances, medical evidence must be available supporting the decision to grant a pension on the grounds of incapacity.

### 1.6 COMMUNICATION OF BENEFITS TO EMPLOYEES

As with all employee benefits effective communication is important for both employee understanding and for the business to gain value from its financial input. Ideally, this may be achieved in the context of an overall handbook that covers all employee benefits.

Alternatively, where there is a separate booklet describing a pension scheme, benefits from supplementary arrangements such as an IP scheme might be covered in the same place. Where an IP scheme is being offered in isolation or where the employer is a relatively small undertaking, greater reliance may be put on information provided from the policy's insurer. This may be by way of an initial announcement letter or by a scheme summary/booklet.

As well as emphasising the continuation of a reduced salary to employees during absence, the employer should also make their employees aware of additional services offered by the insurer. This may be in the form of professional rehabilitation services, access to "best doctors" or even help for the payment of an operation or medical procedure.

### Summary

In this Chapter we have considered some of the sources of income that are available to those who are unable to work because of sickness or disability.

We have considered the various sources of State support, in particular:

- Statutory Sick Pay
- Incapacity Benefit (being replaced by ESA and its various components)
- Severe Disablement Allowance
- The Working Tax Credit
- Disability Living Allowance
- Industrial Injuries Disablement Benefit
- Income Support
- Pension Credit.

We have explored the structure and basic eligibility requirements of each benefit and the current payment rates.

This Chapter has also addressed the disability benefits that are provided by an employer such as group income protection including:

- Basic terms and conditions of an insured IP arrangement
- The design features
- Costing basis
- Taxation.

Finally, we have also covered the ill health retirement options available from the occupational pension scheme.

### Self Test Questions

- After what period of sickness is statutory sick pay applicable?
- State the two elements of the pension credit and explain the differences?
- How is the working tax credit administered and who is it designed to help?
- List the key features associated with an income protection insurance arrangement
- Summarise the tax treatment of benefits and contributions under an income protection insurance scheme.



## CHAPTER 2

# Health Care, Personal Accident and Critical Illness Schemes

### INTRODUCTION

Private Medical Insurance (PMI) is intended to provide for medical expenses incurred during acute illness or injury. These costs can include surgical operations, consultations, diagnostic investigations and procedures such as blood tests and scans. These can be received either as an in-patient, day-care patient or as an outpatient. Generally, unless the private medical insurance scheme is very large and has bespoke benefits, chronic conditions are not covered.

Private Medical Insurance should not be seen as a substitute for the National Health Service (NHS). The purchase of PMI provides pre-planned access to prompt medical treatment for an eligible condition. The purchase of PMI does not mean that superior treatment is being obtained outside the NHS.

#### *USA Experience*

In the USA, the majority of the population is covered by insurance. The USA is therefore an important source of information on medical expenses insurance, and the UK market has traditionally looked to the US market for statistics and ideas.

#### *UK Provision*

In the UK, the largest insurer is Bupa which is a provident association, and there are others such as WPA. These are insurance companies that are run on a “not for profit” basis. In recent years commercial insurers, such as AXA PPP, have entered the market and they are taking an increasing share.

#### *Pensioners*

Historically, around 10% of the companies who provided private medical insurance to active employees provided private medical cover to some of their pensioners. This percentage has fallen dramatically in recent years. Most employers have withdrawn this benefit to new pensioners. It is a substantial liability as the claim rate could be expected to double at these higher ages. Both US and UK accounting rules mean that, in certain circumstances, a reserve for this insurance needs to be included in the company accounts.

#### *Interaction with the National Health Service (NHS)*

An important aspect to note is that private medical insurance does not usually provide for all healthcare to be funded privately – it is generally complementary to the NHS. Primary care (GPs), normal childbirth and maternity care, accident and emergency, intensive care and chronic conditions are almost exclusively provided by the NHS. It is not the purpose of private medical insurance cover to deal with routine matters that can be readily dealt with by the individual’s general practitioner. It is the role of the general practitioner to determine the extent of and whether specialist care or an operation is required, and normally it will be necessary for a valid claim, for the patient to have been referred by his or her own doctor.

### *Employer's Objectives*

An employer who includes private medical care as a benefit usually has the following objectives:

- attracting and retaining employees
- minimising absence
- increasing productivity.

Also, cover will often be provided for the employee's spouse/partner and children. The cost of this may be paid for by the employer, or the employee.

## **2.1 PMI BENEFITS GENERALLY PROVIDED**

### **2.1.1 Expenses Refunded**

A standard Health Care Scheme or PMI contract will refund, perhaps up to stated limits, the following:

#### *In Patient Hospital Charges*

These include:

- Nursing
- Accommodation
- Operating theatre fees
- Prostheses
- Surgical dressings
- Drugs
- Private ambulance (where medically necessary)

#### *In Patient Surgical and Medical Charges*

These include:

- Surgeons' fees
- Anesthetists' fees
- Physicians' fees
- Radiotherapist fees
- Consultation charges
- Pathology
- Radiology
- Scans (MRI, CT or PET)
- Radiotherapy
- Chemotherapy
- Biological therapy (monoclonal antibody treatments such as Herceptin®, Avastin®, Tarceva® and the like)
- Physiotherapy

#### *Outpatient Charges*

These include:

- Consultations
- Pathology
- Radiology
- Scans
- Radiotherapy
- Chemotherapy
- Biological therapy
- Physiotherapy

### *Home Nursing Charges*

These are in practice rare since the nursing care must be both medically necessary on a continuous basis and under the supervision of a specialist. If paid it is usually for a limited period.

### *World Coverage*

Cover is generally provided for emergency treatment received overseas and inevitably shortfalls will occur, as benefit levels are designed to meet the cost of treatment in the UK. If treatment is received in the US in particular, significant shortfalls will be experienced. Benefit is not provided if the plan member explicitly travels overseas to receive treatment. With all plans it is necessary to obtain the authorisation of the insurer before treatment is received. Evacuation and Repatriation may also be covered.

### **2.1.2 Levels of Cover and How Cover is Costed**

It is common to offer different levels of cover that attract different premium rates. These are typically based on where the treatment takes place – postgraduate teaching hospitals, provincial teaching hospitals, general hospitals, or private hospitals. Central London hospitals are generally more expensive and often included at an additional cost.

Most insurers have now developed preferred provider “Networks” whereby the benefits and premiums are not based on hospital category and cover hospitals UK wide.

There may be a simple full recovery of fees where usually the insurer pays the hospital fees direct – or with some providers there may be a maximum benefit that may be claimed in a policy year, e.g., £50,000. Some providers include the option for the policyholder or in the case of a group scheme the member, to pay the first (say) £100 in the event of a claim. This is called an excess and its inclusion has the effect of reducing the premiums.

In relation to group schemes the insurers calculate the cost based on the scale of cover chosen, the type of the client's business, its location, the age of the employees covered, whether any family members are included, and any excess adopted.

Consideration is also given to the hospitals that can be used – e.g. network scale (a limited list restricting choice), Standard or London Upgrade. Other factors which most greatly impact costs include underwriting and out-patient benefit.

Company paid schemes can be either Community/Age Rated or Experience Rated (usually for 100 plus members).

### *Community Rated (Age Rated)*

The most important aspect of these schemes is that the premiums for each member is based on the member's age and these premiums are based on the groups own claims performance along with insurer's underlying claims experience for that entire book of business. The insurers tend to have various pools reflecting low to high claiming groups and therefore different rate tables to reflect this. Statistical evidence shows that certain locations and industries present a higher or lower risk – with the cost therefore varying accordingly. The benefit of this approach is that the quoted cost price accurately reflects the expected claims of an individual company and hopefully provides future premium stability. This type of private medical insurance scheme is normally best suited to groups that include up to 100 employees (plus dependants).

### *Experience Rated (Claims Rated)*

Premiums are based on the claims experience of the membership of that particular group and the premiums for the members will be the same regardless of the member's age with members over the age of 65 typically being charged a higher rate. This can be an attractive option where there are a large number of members in a group (normally 100 or more employees plus dependants) – in effect forming their own community. This enables the insurer to charge a premium based upon the expected level of claims for the group in question.

### **2.1.3 Policy Exclusions**

Not all treatments are covered under a PMI scheme. Except for large employer paid group plans, the norm is that members are not covered for known pre-existing medical conditions at the time of joining. Other exclusions found in the marketplace vary between PMI providers and may for example include:

- optical care
- routine dentistry (although “oral surgery” may be included i.e., removal of impacted wisdom teeth)
- routine maternity care (although “specified obstetric procedures” may be included such as necessary Caesarean Sections)
- prophylactic surgery
- primary care (GPs)
- chiropody
- psychotherapy
- alcohol and drug abuse related conditions
- geriatric care
- cosmetic surgery (unless it is an integral part of a surgical procedure that is covered)
- long term psychiatric care
- chronic medical conditions
- alternative medicine – such as Homeopathy, (although some PMI policies will allow alternative treatments if they are recognised by the British Medical Association).

Cover for the standard exclusions noted above exclusions can sometimes be provided at an additional cost.

## **2.2 BASIS OF PROVISION**

### **2.2.1 Main Categories of Medical Expenses Insurance Schemes**

There are four main categories of medical expenses insurance schemes:

- Individual Purchase Plans
- Affinity Group Plans
- Voluntary Group Plans
- Company Paid Plans.

The market is split approximately 25% Individual Purchase Plans and 75% Group Plans.

Affinity Group Plans are those set up to cover diverse groups of people such as trade unions, credit card holders and members of professional bodies. Voluntary Group Plans are company plans where the employee pays all or part of the premium. Where a Company Paid plan is only available for employees, employees may opt to cover their dependants on a voluntary basis at their own cost.

### 2.2.2 Types of Cover

Medical expenses cover falls into three main areas as detailed below – Fully Insured, Cost Plus and Self Insured.

#### *Fully Insured*

At the beginning of the contract period a premium rate is agreed, and this is paid regardless of the actual claims experience of the group over the contract year. At the end of the year, the claims incurred and paid are considered. The following year's premium will be based on typically 3 years claims data weighted towards the current years claims performance to better understand likely future funding requirements.

There are also available Fully Insured plans, with a Profit Share, or Risk Share element.

With profit sharing, at the end of the year, the insurer will compare the actual amount of claims with the premium paid. If the claims are lower than the claims fund, the difference will be repaid either in full, or an agreed percentage (say 50%) depending on the contract. If the claims are higher, no action is taken to obtain the deficit, but the insurer will obviously take into account that claims experience when calculating future premiums. Some insurers will only pay a profit share if the scheme renews with that insurer.

Risk sharing works in the same way as profit sharing, but with the insured paying any deficit up to a stated upper stop loss level (say 120% of the claims fund), and receiving any surplus to a stated lower stop loss level (say 80% of the claims fund)

#### *Cost Plus*

This is a similar concept to risk sharing above, but rather than a proportion of the surplus/deficit being refunded/paid the whole amount is refunded/paid. The plan will have an aggregate stop loss level set that limits the policy holder's liability (say 120% of the claims fund) and the insured will only be liable for the cost of claims up to that level during the contract year.

#### *Self-Insurance*

The employer pays for all claims. In order to do this a health trust must be set up which has to be approved by the local HMRC tax inspector. The employer can focus on the services being bought and their price and will retain the investment earnings on the funds that would have been paid as a premium, funds that for some companies can run into millions of pounds. Administration can still be carried out by an insurer. Insurance Premium Tax (IPT) does not apply to self-insured plans, but Value Added Tax is applied to the administration charges. Should the health trust purchase aggregate stop loss insurance or specific stop loss insurance, IPT is applicable to the stop loss premium. Specific stop loss insurance limits the claim liability in respect of any individual member of the trust to a specific financial limit in a scheme year (£35,000, or £50,000 for example).

## 2.3 TAX TREATMENT

### 2.3.1 Individual Plan

The premium is usually paid from income from which tax and NI contributions have already been deducted. Despite the removal of income tax relief on policies for the over 60s, many providers still offer specialist policies to deal with the specific needs of those over retirement age.

### 2.3.2 Insurance Premium Tax (IPT)

Since 1 October 1994, IPT has been levied on medical expenses insurance policies. The rate was originally set at 2.5% but has increased considerably over time and now stands at 12% effective from 1 June 2017 and still at this rate in 2022/23.

The contributions made to a self-insured trust fund are not subjected to IPT where contributions are met by the employer, except in respect of any stop loss insurance.

### 2.3.3 Value Added Tax (VAT)

With private healthcare schemes, VAT, at 20%, applies only to the administration charges of a Healthcare Trust.

### 2.3.4 Group Plans

Employees, and directors, are chargeable under Section 203 of the Income Tax (Earnings and Pensions) Act 2003 on the premiums paid by the employer.

The employer receives tax relief on its contributions – they are treated as an allowable business expense.

## 2.4 CLAIMS CONTROL AND COST CONTAINMENT

In recent years, there has been a significant increase in claim costs and hence premium rates. If these increases are allowed to continue insurance will become too expensive, hence the insurers are looking at ways to limit the increases. This has led to a new range of products with reduced benefits, and/or incentives, to encourage lower claim costs, the ideas for which have come from similar practices in the USA.

### 2.4.1 Managed Care

Insurers require the claimant to contact a helpline before treatment takes place. The insurer then has an opportunity to be proactive in routing the individual to the most cost-effective course of treatment. This may involve:

- routing to NHS/lower cost private hospital
- routing to day care rather than in patient care
- preauthorisation and concurrent review of long in patient stays, particularly for psychiatric conditions
- provision of non-standard benefits, e.g., wheel chair ramps, taxi fares etc. if these will allow early discharge from hospital and are cost effective
- provision of second opinions if initial diagnosis recommends expensive surgery.

The collective term for these practices is Managed Care.

### 2.4.2 Directional Care (Guided Referral)

A recent development in cost containment that is beginning to become popular is “directional care”. This is a practice whereby, either by the terms and conditions of the private medical insurance scheme (compulsory) or via the Managed Care process (optional), members have to, or are encouraged to use “preferred suppliers” for their private treatment.

These preferred suppliers will have agreed to provide their services (subject to agreed protocols and clinical standards) at specially agreed charges in return for the volume of business that the arrangement will generate. Directional care may involve:

- using a specific hospital group
- using a specific group of specialists
- using specified diagnostic centres
- using a specified network of physiotherapists
- obtaining “open referrals” from the members General Practitioner to facilitate the above.

### 2.4.3 Deferred Access Plans (6 Week Wait Option)

The eligibility for the benefit depends on the length of the waiting list for the treatment under the NHS. Usually there would have to be a wait of six weeks or more under the NHS before private treatment would be covered. This has been more popular in the individual policy market.

### 2.4.4 Excesses

Excesses are a common feature of motor and household insurance and have been extended to medical insurance for some time. This is where the first part of a claim is paid by the insured. Excesses can be on either “a per claim basis” (e.g., £50 per claim) or a “claims per person per year basis” (e.g., £100 per year), and result in a lower premium.

The “per claim” basis can lead to disputes if one particular medical condition leads to another and the “per person per year” can cause problems if a course of treatment spans a scheme renewal date when the excess will be applied twice. This problem can be minimised by operating on a “rolling 12 months” basis whereby the period that the excess applies to is a 12-month period starting from the date of the first treatment.

The effect on the premium is typically a 5% saving for an excess of £100 per person per annum.

Including compulsory excess on outpatient claims reduces the number of small claims, which make up a large proportion of the total number of claims and hence a large proportion of administration costs. The cost of administering a claim varies little with size. Hence small claims cost a disproportionately large amount when compared to larger ones.

However, current thinking is that it is not always desirable to create a barrier to receiving private treatment from a private medical insurance scheme. This is because it could lead to increased sickness absence costs and/or medical conditions remaining untreated leading to serious consequences.

### 2.4.5 Co-insurance

This would take the form of, for example, the insured meeting 10% of the cost (say subject to a maximum of £1,000) and the insurer meeting the other 90%. It both discourages unnecessary use of treatment and encourages the insured to seek the lowest cost treatment available. This approach could be expected to reduce the premium by around 8%. This cost saving method is not common in the UK and not all insurers are able to administer it.

### 2.4.6 No Claims Discount

This concept in medical expenses insurance operates in a similar fashion to motor insurance, which applies to Individual rather than Group Plans. Each year of no claims results in a further discount applied to the premium, for example:

Year 1	No discount
Year 2	20% discount
Year 3	30% discount
Year 4 onwards	40% discount

### 2.5 ELIGIBILITY AND COSTS

Individual plans, small company paid plans and small voluntary group plans will usually be individually underwritten i.e., using questionnaires or a moratorium. Employers with larger plans, say over 20 employees, will usually be able to negotiate nil, or much reduced, medical underwriting requirements and this may include cover for pre-existing conditions. This is termed “Medical History Disregarded” or MHD. In return, the insurer will insist that the plan covers all employees in a defined category, i.e., the company cannot just insure the “bad risks”.

#### 2.5.1 Full Medical Underwriting (FMU)

This is where applicants for medical insurance have to complete a detailed questionnaire that is designed to find out whether any medical conditions are already present. Applicants with pre-existing conditions will usually be accepted for insurance, but treatment for those conditions will usually be excluded. If the policyholder then develops a condition of which they were not aware at the time of purchasing the insurance, they will be covered.

Factors such as occupation, diet, alcohol consumption and smoking can pay a large part in determining an individual’s health care costs.

#### 2.5.2 Moratorium

With this method applicants are not required to make any declaration of their health history, but a blanket exclusion is placed on their membership detailing that they will be excluded from treatment of any pre-existing medical condition that they were aware of or have had treatment for in the 5 years prior to application, for a period of 2 years (or longer). Should they have treatment or seek advice for these conditions in the 2-year period, this period will extend indefinitely until they have gone for 2 full years without any treatment or advice for these conditions.

#### 2.5.3 Scheme Transfers

If a member transfers from one scheme to another, or an entire scheme transfer from one insurer to another, it may be possible to do this on a “Continued Personal Medical Exclusions” (CPME) or “No Worse Terms” (NWT) basis. This means that the member(s) will not be subject to new underwriting but carry any existing exclusions with them to the new scheme.

### 2.6 OTHER DESIGN FEATURES

Other features often included in a policy are:

- NHS Cash Benefit
- Employee Contributions
- Mental Health
- Maternity Cash Benefit or Baby Benefit.
- Wellness
- Cancer Cover

#### 2.6.1 NHS Cash Benefit

This is paid when NHS public facilities are used and is designed to cover out of pocket expenses when using the NHS and act as an incentive to use the NHS when adequate treatment is available. A typical amount might be £100 per night up to 25 nights.

#### 2.6.2 Employee Contributions

Most employers pay the premiums, but it is of course possible to introduce employee contributions (on which no tax relief is available). They could, for example, be introduced just for the cost of the dependants’ benefit.



### **2.6.3 Psychiatric and Addictive Conditions**

Psychiatric benefit is an area that can be abused, and some companies are moving to restrict benefits here by reducing the number of days for which the benefit is paid. Typically, 28 in patient nights per benefit year is the norm. Some insurers provide an annual maximum of £15,000 per benefit year for all in patient and outpatient treatment.

### **2.6.4 Maternity Cash Benefit or Baby Benefit**

This benefit is a cash sum (usually £100) payable on the birth of a child. This benefit would normally only be payable if the member had been covered by the plan for a minimum of 10 months.

### **2.6.5 Regulation**

The selling and administration of private medical insurance, other health insurance such as health cash plans, dental cover and primary care insurance, and all forms of general insurance has been regulated by the Financial Conduct Authority (FCA), previously the Financial Services Authority (FSA) and Prudential Regulation Authority (PRA). The catalyst for FSA regulation was the Insurance Intermediaries Directive adopted by the European Parliament in September 2002, which requires member states to regulate persons selling general insurance and reinsurance.

## **2.7 PERSONAL ACCIDENT SCHEMES**

According to a report issued by the Office of Fair Trading in 1996 into health insurance, the penetration of protection products is typically lowest amongst the young. The biggest cause of death and disability for young people is an accident. According to the Office of National Statistics the estimated toll of accidents among young adults is over 4,000 lives each year. Personal Accident and Sickness Schemes are concerned with covering bodily injury caused by accident, or inability to work due to sickness.

Schemes provided by employers may either be totally funded by the employer covering all or just certain classes of employee or may be available for employees to join on a voluntary basis and at their own expense. In the latter type of scheme substantial cost savings are available to members as compared to simply purchasing cover themselves on the open market.

### **2.7.1 Benefits Provided Under Personal Accident and Sickness Schemes**

Where provision is made by the employer benefits may be either on a fixed scale or salary related. In the latter instance cover will be expressed as a multiple of salary in the event of accidental death or Permanent Total Disability (PTD) with proportionate sums payable in the event of loss of limbs etc.

With regard to schemes involving voluntary membership, it is usual for a range of benefit level options to be available which may be expressed as fixed scales or as units of benefit with the employee choosing how many he wishes to purchase.

A typical scale of benefit might be for example:

Permanent Total Disability	£100,000
Loss of sight in one or both eyes or loss of use of arm, hand or leg above the knee	£100,000
Loss of hearing in both ears	£40,000
Loss of hearing in one ear	£10,000
Loss of use of:	
A leg below the knee or a foot	£50,000
A shoulder or elbow	£25,000
A hip, ankle, knee, wrist, or a thumb	£20,000
Any finger or big toe	£10,000
Any other toe	£5,000
Accidental death	£50,000
Hospital Cash Benefit	£100 per day
payable for up to	104 weeks
Home convalescence Benefit	£400 per week
after at least seven days in hospital, for up to four weeks.	

The cost of such a benefit scale will depend on the occupation class of the group to whom cover is being offered and may be set up on an employee only basis, employee and spouse, or for full family cover with the cost adjusted accordingly.

### 2.7.2 Benefit Restrictions

All of the events described in the above scale of benefits which may lead to a claim are in any event subject to close definitions in the policy documentation for the avoidance of any doubt.

For example, Permanent Total Disablement (PTD) may be defined as “the policyholder’s inability to perform or give attention to each and every duty of his or her occupation”. In more easily understandable terms, another possible definition might be “disablement caused other than by loss of limb or eye which having lasted for at least 12 months will in all probability entirely prevent the employee from engaging in his or her usual occupation for the remainder of his or her life”. Less strict definitions will generally be applied in respect of a spouse or children where covered, which may refer to “any occupation for which he or she is fitted by reason of education training or experience”, but again the disability must by definition be of a permanent nature.

There are in addition specific exclusions which may apply.

For example, benefits may not be payable in respect of bodily injury as a result of:

- suicide or self-inflicted injury
- war and kindred risks
- full time military service
- flying as a pilot or aircrew.

It is most usual for cover to be provided without restriction, i.e., 24 hours a day and worldwide.

However, when cover is provided by the employer, it may be that cover is only available whilst the employee is engaged on business on behalf of his employer. Such cover will be provided automatically for the employee by the employer. Schemes which do not impose such a restriction may be either automatic or voluntary, which in effect means either totally employer funded or merely the availability of a scheme which the employee may choose to join and if so at a cost which because of the operation of group terms will be highly competitive.

### 2.7.3 Tax Treatment of Benefits and Contributions

Where the cost of cover under a Personal Accident scheme is met by the employer, the premium will be taxable on the employee as a benefit in kind (but see also section 2.8.4). Benefit payments are however tax free in the event of a claim, except for sickness benefits which are taxable. The premiums are allowable for tax as a business expense to the employer.

Where the scheme is voluntary, contributions will generally be collected from the employee by direct deduction from pay however there is no relief against income tax, and benefits are tax free. This is due to the operation of exactly the same rules as apply to individual Income Protection policies.

## 2.8 CRITICAL ILLNESS SCHEMES

Employers vary widely in the way they choose to make provision for employees who are diagnosed or undergo a surgical procedure with one of a number of defined medical conditions known as a critical illness.

A lump sum benefit is paid to employees (usually covered by an insurance policy) who suffer one of the critical illness events listed under the policy. For those events that are medical conditions, the date of the event is the date that formal diagnosis is made; for surgical procedures, the date is the date of actually undergoing the procedure. The employee, spouse/registered civil partner or child, as appropriate, must survive a period of time that the insurer stipulates from the critical illness event, after which the claim will be processed.

The benefit design features of a critical illness scheme that can be provided as an insured benefit by employers are considered below.

### 2.8.1 Design Features of Critical Illness Arrangements

The conditions of covering entry into the policy must be selected. An employee can become a member if they satisfy the conditions of eligibility defined in the critical illness policy and meet the definition of being actively at work.

Benefit may be provided as a fixed amount or as a multiple of earnings. Normally, the maximum benefit payable per employee is four times earnings to a maximum of £500,000, or £250,000 with no salary-based limitations.

There are two types of cover available, Base and Extra (otherwise known as Core and Additional) Cover. Base cover provides cover for some of the most serious critical illness events (such as Cancer, Heart attack, Kidney failure, Stroke), where Extra cover insures all the conditions listed under Base cover plus a wide range of additional critical illness events (such as Coma, Heart surgery, Blindness, Deafness).

Depending on the size of the scheme membership a level of medical evidence free cover will be available known as the free cover limit (FCL) or Automatic Entry Level (AEL). If an employee's benefit entitlement goes over the free cover limit, they will need to provide medical evidence before full cover can be considered.

### 2.8.2 Taxation of Benefits and Contributions

The whole cost of a standard Critical Illness policy is usually met by the employer.

#### *Employer*

Premiums paid by the Policyholder (i.e., the employer) to insure employees against Group Critical Illness events are an allowable expense and can be offset against Corporation Tax. The employer is liable for Class 1A National Insurance Contributions on the premiums.

### *Employee*

The employee is taxed on the amount of the premium paid on their behalf by their employer as a benefit in kind. Benefits are paid to the member tax free.

### **2.8.3 Communication of Benefits to Employees**

As with all employee benefits effective communication is important for both employee understanding and for the business to gain value from its financial input. Ideally, this may be achieved in the context of an overall handbook that covers all employee benefits.

Where however a scheme such as a Critical Illness scheme is being offered in isolation or where the employer is a relatively small undertaking, greater reliance may be put on information provided from the scheme insurer. This may be by way of an initial announcement letter or by a scheme summary/booklet.

### **2.8.4 Changes to Taxation of Expenses and Benefits in Kind**

Three significant changes in the taxation of expenses and benefits in kind that employers give to their employees took effect from 6 April 2016. These are:

- Abolition of the £8,500 threshold for taxing certain benefits in kind
- Voluntary 'payrolling' of benefits in kind
- Replacing dispensations with an exemption for paid or reimbursed expenses.

More information for employers on benefits and expenses can be found at - <https://www.gov.uk/employer-reporting-expenses-benefits/dispensations>.

## **2.9 OTHER SPECIALIST COVERS**

### **2.9.1 Keyman Cover**

Many businesses fail to protect themselves from the financial consequences of one or more of their most important assets, namely the key people that they employ. The purpose of Keyman insurance is to protect the company that purchases the cover from losses arising from the loss of the services of key individuals connected with the company due to accident or sickness. Such cover is occasionally known as "Economic Death Insurance". Another issue that may require protection is where a business has borrowed to support a particular project or tends to rely on a substantial overdraft for the purposes of day-to-day trading.

The cover may be in respect of disablement or death and such cover may be purchased individually or in a package that covers death, disablement, and critical illness.

There are many possible examples of people that may be key.

#### **Examples**

- A shareholder director that might be central to a small business.
- A sales director where personal contact with key customers might be central to their ongoing support.
- Specialist technical personnel who are for example involved in a key new product development. It is possible to clearly envisage this for example in fast growing information technology or biotechnology companies.
- A Project manager whose control and input may be vital in the successful completion of a civil engineering project for example where any time overrun's due to the loss of this key resource may involve crippling financial penalties.

### *Sum Insured*

The sum insured must represent the proven value of the individual and may be related to the company's turnover or profits or may in some way be linked to the individual's contract of employment or some other contract in which the individual's continued involvement is vital.

Sums insured will always be substantial and cover of up to £25 million per person is readily available in the market. Depending on the level of cover increasing degrees of medical information will be required for underwriting purposes. Financial underwriting will also be necessary, to show that the sum assured is reasonable in relation to the loss to the business of the key person's death or disability.

For example if the key person frequently travels abroad on the business of the employer, extra cover against accidental death and/or sickness may be arranged to give additional protection to the individual and his family for the duration of the trip.

### *Taxation Position*

The tax treatment is described in HMRC's Business Income Manual, an extract from which is provided below. Further details are available at - <http://www.hmrc.gov.uk/manuals/bimmanual/BIM45500.htm>.

An employer may take out in their own favour a policy insuring against loss of profits resulting from the death, critical illness, sickness, accident or injury of an employee, director or other 'key person'.

The premiums on such a policy will be allowable if all the following conditions are met:

- The sole purpose of taking out the insurance is the trade purpose of meeting a loss of trading income that may result from loss of the services of the key person, and not a capital loss. Guidance on possible non-trade purposes is at BIM45530.
- In the case of life insurance policies, they are term insurance, providing cover only against the risk that one or more of the lives insured dies within the term of the policy, with no other benefits. The insurance term should not extend beyond the period of the employee's usefulness to the company.

The premiums on whole life or endowment policies, or critical illness or accident policies with an investment content - such that premiums contribute to a capital investment - are capital expenditure and will not be deductible, see *Earl Howe v CIR* [1919] 7 TC 289.

Cover in respect of kidnap and ransom of such individuals is also available but as would be expected this business is transacted on a highly individual and indeed secretive basis.

### **2.9.2 International Private Medical Insurance**

This insurance is for expatriates, or third country nationals working on an expatriate employment contract outside of their country of domicile. The plans provide the same benefits as UK Private Medical Insurance plans, except they tend to offer full refunds with annual claims limits of typically £1 million.

Chronic conditions are typically covered, and options are available to cover primary care, routine dentistry, and maternity.

Medical evacuation by air ambulance is provided where treatment is not available in the location where an expatriate may be working, to either their country of domicile or the nearest country where suitable treatment can be received.

Typically, there are three levels of cover, Europe, Worldwide excluding the USA, and Worldwide and include direct settlement between the provider and the insurer.

24/07 Helplines are provided to enable members to authorise treatment, and to obtain general health advice and information.

Plans are available for individual purchase and employer group plans.

### Summary

This Chapter has looked at private medical insurance arrangements, the providers of such arrangements, and the key features and benefits of them. It has considered the scope of the cover available in such schemes and how these schemes are costed.

Some of the design features of critical illness benefits that are available to employees through an employer arrangement have been considered.

The Chapter has also dealt with private healthcare schemes:

- benefits provided under personal accident and sickness schemes
- benefit restrictions
- tax treatment of benefits
- tax treatment of contributions
- Keyman cover
- critical illness insurance.

### Self Test Questions

- List the objectives that are typical of an employer in providing a private medical care scheme.
- List six typical exclusions associated with Group private medical care policies.
- State what is meant by the term “cost plus” in the provision of private medical insurance.
- What is the purpose of Keyman insurance and on what basis would the sum assured be calculated?
- What main benefits are payable under a Personal Accident and sickness scheme?
- What taxation differences are there to the individual for employer paid and voluntary Personal Accident and sickness schemes?
- Describe the two types of cover which can be provided under a critical illness scheme?
- Summarise the tax treatment of benefits under a critical illness insurance scheme.

## PART 3

# FLEXIBLE BENEFITS AND SALARY SACRIFICE

### OVERVIEW

This Part looks at various other types of benefits that may be available to an employee.

Chapter 1 looks at company share plans. These can be offered to the majority of employees or as a form of executive or senior employee incentive. Share plans are a method of providing employees with the ability to purchase shares in the company at a discounted rate, which will hopefully lead to increased returns at maturity and encourage “employee buy in” to company success.

Chapter 2 looks at how a flexible benefits package might be introduced, and the mechanics involved if one is introduced. Flexible benefit packages are becoming increasingly important. With a greater number of employees looking for bespoke packages (i.e., ones more tailored to their particular lifestyle) flexible packages are becoming more attractive as it allows personal tailoring.

Chapter 3 looks at salary and bonus sacrifice. This process allows an employee to sacrifice part of their salary for certain benefits, such as pension, and in doing so benefit from lower National Insurance payments and possible higher pension scheme contributions.

Finally, Chapter 4 looks at a number of other types of benefits that may be offered to employees.

# CHAPTER 1

## Company Share Plans

### INTRODUCTION

Company employee share plans have over the last 30 years become one of the most common and attractive employee benefits. These plans provide employees with the opportunity to acquire shares in their company on favourable terms, and in some cases with a degree of protection against market downturn. Share ownership enables employees to participate in the financial success of their organisation and to identify more closely with its longer-term success. The majority of companies that operate employee share plans are listed on a UK or overseas stock exchange, but some private companies also operate such plans.

Successive governments have seen the desirability of encouraging wider share ownership through employee participation and have encouraged the growth of employee share ownership through tax privileges for particular plan designs, known as “approved” plans. To gain approval, schemes must be submitted to HM Revenue & Customs (HMRC) prior to commencement and must comply with detailed rules set out in the Taxes Acts – information can be found on the HMRC website at [www.hmrc.gov.uk/shareschemes/](http://www.hmrc.gov.uk/shareschemes/)

According to latest HMRC statistics:

- There were over 16,300 companies operating a tax-advantaged share scheme in the UK at the end of 2021.
- The total cost of Income Tax and National Insurance relief for all 4 types of approved employee share schemes (see below) exceeded £760m.

<https://www.gov.uk/government/collections/employee-share-schemes-statistics>

Employers can encourage employee share ownership in two ways:

- giving employees the right to buy shares in the future at an advantageous price (option schemes)
- by “giving” shares to employees or giving a discount on purchase.

Normally, such schemes have a prescribed period that employees must wait before the shares become theirs or can be sold – known as the “vesting” period. This is a required condition for tax approved plans in order that they are not simply a tax-free salary substitute. The restriction does also serve the purpose of encouraging employees to stay with the employer and is one reason for their popularity with employers.

### 1.1 WHY WOULD A COMPANY OPERATE A SHARE PLAN?

Companies operate share plans for several reasons. All employee plans (such as approved Save As You Earn plans described in Chapter 1.2 and approved Share Incentive Plans described in Chapter 1.4) are used as a motivational tool for improving employees’ commitment and alignment to the company. These plans can also be used as an alternative to cash profit sharing, as a way of sharing the proceeds of success with employees. Individuals who have a stake in the company they work for are, it is hoped, going to have a greater interest in its financial performance and a better understanding of the need for profit.

However, not all share plans are extended to all or even most employees. Selective share plans (such as approved Company Share Option Plans and Enterprise Management Incentives described in Chapter 1.3 and unapproved plans described in Chapter 1.5) normally offer much larger opportunities and are used as a form of long-term bonus as an incentive for senior employees and executives. These plans also provide a loyalty “handcuff”, since failure to remain with the company for the vesting period (typically three years) normally results in a loss of the shares.



Finally, companies are often prompted to introduce share plans because of a particular situation they face. For example, a private company going public for the first time may seek to allay the fears of its employees that the company will be losing its “family” feel by awarding free shares or giving them an opportunity to buy shares on favourable terms at the time of flotation. Or a startup business may seek to attract talented employees but have limited cash to pay salaries and bonuses: the promise of a substantial capital gain through the award of shares may fill the gap.

### 1.2 APPROVED SAVE AS YOU EARN (SAYE) SHARE OPTION PLANS

SAYE plans (also known as “share save plans”) were introduced in the 1980 Finance Act but are now governed by Schedule 3 of the Income Tax (Earnings and Pensions) Act 2003. There are currently around 570 live approved SAYE plans.

The key feature of an SAYE plan is that it provides an opportunity for employees to save up (in a tax efficient way) to buy company shares in future at today’s price, with no obligation to do so if the price falls before then.

An SAYE plan comprises two elements. Employees are granted an “option” – a right to buy company shares in future at a discount of up to 20% on today’s price. At the same time, the employee takes out a tax-free savings contract to pay for the shares by deduction from their monthly salary over a three or five-year period. The share options are exercised at the end of three, five or seven years, after which the monthly savings are supplemented by a guaranteed terminal bonus payment in lieu of interest (current bonus rates are published at - <http://www.hmrc.gov.uk/shareschemes/saye-change-bonus.htm>).

The result is that the employee is able to buy shares in future for less than today’s price. However, it is important to note that employees who participate in a SAYE scheme are not obliged to buy shares with their savings. This means that if the employers’ shares have performed poorly, they can simply take their savings, plus interest, at the end of the term. This “no lose” situation has made SAYE popular among employers and employees, particularly in companies where the workforce may be unfamiliar with shares and be wary of the risks associated with share ownership. Tax approval means that the profit that employees make on buying shares below their true value escapes Income Tax, though it may be subject to Capital Gains Tax when the shares are sold. It is also possible to transfer the shares into an Individual Savings Account (ISA) which eliminates even the Capital Gains Tax.

A member of a registered pension scheme may make a contribution by transferring shares into their pension scheme. This may be accepted provided the shares are eligible shares, that is, either:

- if the member has acquired them through a Save As You Earn scheme, they are transferred into the scheme within 90 days of the member exercising the right to acquire them, or
- if the shares have been part of a share incentive plan, they have been transferred to the scheme within 90 days of the member asking for the shares to be transferred to them.

Participation under an approved SAYE scheme is intended for all or most employees and can extend to employees of subsidiary companies of the Group whose shares are being used. The company can set a qualifying period of employment, but this may not exceed five years. In practice, it is common to have no – or a much reduced – service requirement so that most if not all employees can take part. Participation is voluntary – employees may accept or decline the invitation to participate. However, once an employee decides to take part, they must maintain their savings plan or else they lose their right to buy the shares.

## Reward and Retirement Provision

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Before the scheme starts, those who decide to participate must choose:

- how much they wish to save monthly – a fixed amount (in multiples of £1) between £5 and £500 (or a lower maximum limit chosen by the company), and
- whether they wish to have the option to buy the shares after three, five or seven years (if the company gives them this choice – many companies now restrict the choice in order to conserve shares). Note that the period during which monthly savings is made is three or five years only – if a participant chooses a seven-year option he saves for only five years then waits a further two years for the higher terminal bonus. Further, seven-year contracts are no longer available for new SAYE participants from 23 July 2013.

The price per share is determined at the outset and is the same for all participants. At the company's choice the price may be up to 20% below the market value. This value is set on a predetermined pricing day.

The monthly amount they choose to save, the share price after any discount offered, and the length of the option period determines the number of shares over which their option is granted, since this is determined by the value of the savings plus guaranteed bonus to which they have committed. From April 2014, the maximum monthly amount that an employee can contribute to SAYE savings arrangements increased from £250 to £500 at which it remains 2023/24.

If there are insufficient shares available under the scheme to meet the applications, the company may scale down the amount employees save each month, provided this is done equitably, or they may exclude the bonus from consideration.

The monthly savings earn interest at a rate which is fixed by HMRC at outset for the duration of the scheme. The amount saved is deducted monthly, via the payroll, from the employee's net earnings and deposited in a special account with a bank or building society chosen by the company.

The tax-free bonuses are adjusted automatically in line with market swap rates. The bonus applicable at the time the employee enters into the SAYE contract is guaranteed to remain fixed for the life of that contract.

The Bank of England Monetary Policy Committee (MPC) set the Bank of England base rate ('Bank Rate'). The new Bank Rate usually applies from the day following the MPC meeting, when minutes are published. The new SAYE bonus rates will be calculated in line with the new Bank Rate. This was applicable from 18 August 2023.

Rates are announced by Treasury press release and can be found at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk) also they can be found on the HMRC website at [www.hmrc.gov.uk/shareschemes/](http://www.hmrc.gov.uk/shareschemes/).

At the end of the term, employees have six months in which to exercise their options. They can choose to:

- close their account and take the savings, plus bonus, as cash, or
- close the account and use all of the savings, plus bonus, to buy shares at the price granted, or
- have part taken as cash and part used to take up some of the share option.

If an employee leaves service before they have exercised their option, they must lose the right to buy the shares (though not their accumulated savings). Exceptions are provided for in the case of "good leavers" such as retirement, ill health, redundancy or death, when the option can be exercised, within six months of leaving the company (in the case of death, the scheme rules usually permit the personal representatives to exercise the option within one year of the date of death) but only to the extent of the accumulated savings. Income tax relief on exercise is extended to cover these situations, even if they occur within three years of the grant of the option.

### Example

An employee elects to save £30 per month for five years. The share price at commencement is £2 and at the end of the five years is £3.50.

#### Stage 1 – Savings

Total amount saved over five years (60 x £30)	=	£1,800
Tax free bonus added at end of five years (0.9 x £30)	=	£27
Total in the savings account	=	£1,827

#### Stage 2 – Exercise of Option

Option price (£2 - 20% discount)	=	£1.60
Number of shares available on maturity (£1,827/£1.60)	=	1,141 shares
Value of shares at maturity based on current share price (£3.50 x 1,141)	=	£3,993.501

If the shares are sold immediately then there is a gain of £2,167.90 on the original savings of £1,827 including tax free bonus. Of course, this example assumes the share price increases. However, if the share price had fallen below the option price of £1.60, then savings and interest bonus can be taken as cash.

No Income Tax is payable on the difference between the £1,827 used to buy the shares and the £3,993.50 value of the shares acquired. However, when the shares are sold by the employee at the prevailing market price, Capital Gains Tax (CGT) at 18% is liable on the difference between the sale proceeds and the £1,827. However, any gains of less than a specified amount (£6,000 in 2023/2024) are free from CGT. There are plans to decrease the allowance to £3,000 from April 2024.

<sup>1</sup> In addition there is a balance of £1.40 left over in the savings account

For more information on the SAYE plan see the following HMRC guidance <http://www.hmrc.gov.uk/manuals/essum/ESSUM30000.htm>.

### 1.3 APPROVED EXECUTIVE SHARE OPTION SCHEMES (CSOP/EMI)

The Executive Share Option Scheme was originally introduced in the Finance Act 1984 with the aim of providing companies with a tax-efficient means of rewarding and motivating their senior management. The plan is now termed a Company Share Option Plan (CSOP) and is governed by Schedule 4 Income Tax (Earnings and Pensions) Act 2003. According to the latest HMRC data, there are 1,310 live schemes.

The key feature of a CSOP is that it provides an opportunity for selected employees to buy significant numbers of company shares in future at today's price, with no obligation to do so if the price falls before then. A CSOP is therefore similar to an SAYE plan but can be limited to chosen employees only, more shares can be bought and there is no associated savings contract. The other main difference is that "performance conditions" can be put on the options that must be met before the option can be exercised.

Participation in a CSOP is limited to employees or full-time directors (i.e., those working at least 25 hours per week) of the company which set up the scheme, or, if the scheme covers more than one of the companies in a group, any one of the companies in the scheme. To prevent tax avoidance, there is also a restriction on participation by employees with substantial shareholdings – 25% or more – in a "close" company – this mainly impacts on family controlled private companies.

Participants are granted a right (known as an “option”) to buy a fixed number of shares at a fixed price after a set period of time that cannot be less than three years and cannot be more than ten – in practice almost all plans specify three years. The price of the shares is fixed at the time the option is granted and must not be less than the market value of the shares at the time. Tax approval means that the profit that employees make on buying the shares below their true value escapes Income Tax, though it may be subject to Capital Gains Tax when the shares are sold.

The company chooses the size of the option granted but the total value of unexercised share options (based on the market value of the shares when granted) of each employee under an approved scheme must not exceed £60,000. Options in excess of £60,000 can be granted as unapproved options but are not subject to tax relief. The £60,000 limit applies to all outstanding options so if awards are made annually, it is equivalent to around £10,000 a year ignoring share price changes. This is more than the maximum SAYE option value per year. It is worth noting that the limit was increased to £60,000 from 6 April 2023 having been unchanged since 1996.

Most companies operating CSOPs also operate an unapproved share option plan with identical provisions but permitting larger options. The first £60,000 of awards will be tax favoured while the balance will not be.

Unlike an SAYE plan, the employer has complete discretion over which employees are eligible and granted options, and the relative size of options. Most plans are used as an incentive for senior management but there are a few organisations that have granted options across their entire workforce – effectively a SAYE plan without the associated savings contract.

Options are exercisable, generally, between the third and tenth anniversary of the grant. Until that time, the employee does not hold shares, only options, so no dividend payments are made until the employee actually buys the shares. The hope is, of course, that the market value of the shares has increased so that when the employee chooses to exercise, they will buy at a price that is lower than the prevailing market price. In doing so, they may then choose to sell the shares and make a profit. A company may make a loan and sale facility available, so participants can borrow to buy the shares (at the option price) and immediately sell enough shares (at the current market price) to repay the loan.

Companies can (but need not) impose restrictions (“performance targets”) on options. For example, they may require that the option can only be exercised in full if earnings per share (eps) grow by at least inflation plus 10% and may not be exercised at all if eps grow by less than inflation plus 3%. If eps grow between these extremes, a proportion only of the option may be exercised. The purpose of such restrictions is to ensure that participants only benefit from true company performance and not merely a general rise in share prices. Performance targets must be objective and must apply to all options awarded at the same time – it is not permissible to make them specific to individuals. For listed companies, the institutional investor community expects performance targets and has published guidelines on acceptable criteria.

If an employee leaves service before they have exercised their option, they normally lose the right to buy the shares. This reflects the use of the CSOP as an aid to retention by encouraging an executive to stay with the company. Exceptions are provided for in the case of “good leavers” such as retirement, ill health, redundancy, or death, when the option can be exercised, within six months of leaving the company (in the case of death, the scheme rules usually permit the personal representatives to exercise the option within one year of the date of death). Income tax relief on exercise is extended to cover these situations, even if they occur within three years of the grant of the option.

### Example

An employee is granted an option over 5,000 shares and the market value at the date of grant is £1.50. The total value of shares under option is therefore £7,500

Three years later, the share price has risen to £2.25.

If the employee decides to exercise the option then he can do so by writing a cheque to the company for £1.50 per share (i.e. £7,500) and he would then own 5,000 shares valued at £11,250.

No Income Tax is payable on the difference between the £7,500 used to buy the shares and the £11,250 value of the shares acquired, However, when the shares are sold by the employee at the prevailing market price, Capital Gains Tax at 18% is liable on the difference between the sale proceeds and the £7,500 invested. However, any gains of less than a specified amount (£6,000 in 2023/2024) are free from CGT.

Many employees immediately sell at least sufficient shares to recoup the sales proceeds – in this case that would be 3,333 shares – leaving 1,667 shares valued at £3,750. Further shares might also be sold to cover the Capital Gains Tax bill arising on the sale of shares

For more information on the CSOP see the HMRC website at <http://www.hmrc.gov.uk/manuals/essum/ESSUM40000.htm>. From 6 April 2014, companies must self-certify that a CSOP meets the requirements of the CSOP legislation.

The Enterprise Management Incentive (EMI) is similar to the CSOP but is available to smaller private companies only – specifically those with gross assets of less than £30 million and with less than 250 full time employees. The tax breaks are identical to those of CSOPs except that the limit of £60,000 on the value of shares placed under option is replaced with a higher limit of £250,000 over a three-year period (the £250,000 limit applies from 16 June 2012; prior to that date, the individual limit was £120,000). The restrictions on the type of company that can operate an EMI are aimed at encouraging trading companies and excluding financial and investment companies where the share price could be manipulated to create artificial gains.

There are around 14,000 live EMI schemes.

For further information on the EMI see the following HMRC guidance <http://www.hmrc.gov.uk/manuals/essum/ESSUM50000.htm>. Also, for EMI schemes established or options granted post 6 April 2018, see - <https://www.gov.uk/government/publications/employment-related-securities-bulletin/employment-related-securities-bulletin-no-27-april-2018>.

### 1.4 SHARE INCENTIVE PLAN (SIP)

SIPs were introduced in July 2000 as the more flexible successor to approved profit sharing share plans which were the first approved plans to be available in the UK (from 1978). SIPs are governed by Schedule 2 of the Income Tax (Earnings and Pensions) Act 2003. There are around 850 live approved SIPs.

The key feature of a SIP is that it provides an opportunity for employees to be given company shares free of tax or to buy them in a tax efficient way out of pre-tax income. Some companies use them as a form of profit sharing, with the value of shares awarded each year dependent on company profits, while others use them primarily as a facility for enabling employees to invest in their shares cost effectively.

SIPs operate in a different manner to SAYE options. Unlike an option plan, employees become entitled to their shares immediately. However, they are required to hold them for up to five years otherwise the tax relief is clawed back. To enforce this retention, the shares must be held by trustees in a SIP trust.

There are four mechanisms within a SIP that can be utilised by companies. It is not necessary to utilise all of them, and companies can “pick and mix”.

### *Free shares*

An employer can give employees up to £3,600 of free shares in any tax year.

### *Partnership shares*

An employee can buy shares out of their salary before tax deductions. There's a limit to how much an employee can spend - either £1,800 or 10% of income for the tax year, whichever is lower.

### *Matching shares*

An employer can give employees up to 2 free matching shares for each partnership share the employee buys.

### *Dividend shares*

An employee may be able to buy more shares with the dividends they get from free, partnership or matching shares (but only if their employer's scheme allows it). Employees will not pay Income Tax if they keep the dividend shares for at least 3 years.

The shares are tax free provided that they are held for five years in the SIP trust. Reduced tax is payable if they are withdrawn between three and five years from the award date. Special provisions apply for retirees and similar circumstances. Leaving employees are not obliged to withdraw their shares when they leave, if they wish to obtain the full tax relief.

Participation under a SIP is similar to that of an approved SAYE plan. The plan is intended for all or most employees and can extend to employees of subsidiary companies of the Group whose shares are being used. The company can set a qualifying period of employment for free and matching shares, but this may not exceed 18 months (this is shorter than the SAYE equivalent). Participation is voluntary – employees may decline their free shares or choose not to purchase any partnership shares.

Further details are in Appendix A which also compares the features of SIPs and SAYE plans. For more information on the SIP see the following HMRC guidance

<http://www.hmrc.gov.uk/manuals/essum/ESSUM20000.htm>.

## 1.5 UNAPPROVED SHARE PLANS

Whilst approved share plans have the advantage to employees that they can allow shares to be provided to employees without Income Tax consequence, most companies find that they need to also operate unapproved plans for their executives. The reasons for these are:

- The tax-free limit under the all employee approved plans is too small to be of value for executive plans and these plans do not allow for any discretion or performance-related payment.
- For a number of years, CGT rates were aligned with Income Tax rates – in this situation the advantages of approved share plans over unapproved plans were greatly diminished, particularly for executives with other sources of capital gains (and therefore no tax-free annual allowance left).
- As indicated earlier, even the approved share option plan (CSOP) has a limit of £30,000 that in today's world is inadequate, so some sort of unapproved top up is essential.
- Increasingly, the share option mechanism has been seen as unattractive to companies, who have switched over the years away from share options toward “restricted share” plans.

Looking at the two types of unapproved plans separately, they have the following characteristics:

- An unapproved option plan can be identical to a CSOP except for there being no ceiling on award sizes (other than any required by shareholders). Consequently, these plans allow for complete discretion on participation, the type of share under option and the size of individual awards. Indeed, many companies operating share option plans have dispensed completely with the CSOP and operate an unapproved plan only for simplicity.
- A restricted share plan is different from an option. Instead of the employee receiving a benefit equal to the growth in the share price since the award date, holders of restricted shares are entitled to the entire value of the share without any requirement to make a payment on “exercise”. This obviously means that a restricted share awards is more valuable than an equivalent option award – by a factor of around 3:1 – so is normally accompanied by proportionately smaller awards, thus conserving shares for the future. Restricted share plans are also attractive to employees when share prices fall. Under an option plan, this wipes out any potential benefit from the plan, while under a restricted share plan the benefit remains, though reduced in value.

Both plans typically incorporate some sort of company financial performance target that has to be met over the three years before the employee can get any shares – this is generally on a sliding scale between zero delivery and full delivery. For this reason, restricted share plans are often referred to as performance share plans.

Because these plans are unapproved, the gains made by employees are taxed as income on the date that the employee becomes entitled to the shares. In the case of an option, the tax is on the gain in share price since award, while in the case of a restricted share the tax is based on the entire value of the shares. National Insurance contributions are also levied on both employee and employer. Any subsequent share sale may trigger a further Capital Gains Tax charge on gains since the date of entitlement to the shares.

Although restricted share plans are now the most common form of executive incentive today in the UK, there are circumstances where an option plan still has value. An option awarded when share prices are low could have a very high leverage value to an employee if the price recovers. Options also have the practical advantage that until the option is exercised, there is no need to make shares available. By contrast, under a restricted share plan, the shares have to be acquired – and perhaps held by an EBT (see Chapter 1.6) – in order to match the potential payment. Options are therefore easier to unravel in the event that the plan is abandoned (perhaps as the result of being taken over), or the executives leave service (in which case the company may be left with unused shares).

### 1.6 EMPLOYEE SHARE OWNERSHIP PLANS (ESOPS)

Employee share ownership plans (ESOPs) are arrangements by which an “employee benefit trust” (EBT) acquires and holds company shares for the benefit of current, former and future employees in order to support the operation of an employee share plan – in other words, they are not employee share plans themselves. In order to avoid EBTs being used for corporation tax avoidance, there are strict rules on the tax deductibility of payments made by companies into EBTs and in general these have the effect of deferring tax relief until the shares are actually used (rather than when they are acquired by the trust) and even then, only if the shares are taxed as income to an employee. For tax reasons these are generally set up offshore with the trustees being a corporate subsidiary.

To provide some certainty on tax deduction, Statutory ESOPs (also known as “qualifying employee share ownership trusts” or QUESTs), i.e., those qualifying for guaranteed corporation tax relief, were introduced by the 1989 Finance Act as amended by the 1996 Finance Act. A QUEST enabled a company to claim tax relief for the cost of issuing shares at a discount upon the exercise of SAYE options and significantly reduce the cost to the company and its shareholders. However, the previous government abolished QUESTs from 1 January 2003 although shares in existing QUESTs can continue to be used.

Nevertheless, non-statutory ESOPs still have an important role to play in the operation of employee share plans. Specific situations in which they can be helpful include:

- For a private company (whose shares are not traded on any market), an EBT can provide a vehicle for creating an “internal market” in the company’s shares once shares have passed to employees through a share plan. When an employee wishes to sell – or is required to do so (because they are leaving the company for example) – the EBT will act as a “buyer of last resort”
- For a public company that does not wish to dilute its equity by issuing more shares to support an employee share plan, the EBT can be funded to buy already issued shares on the market. This mechanism has also been used by private companies to buy out large shareholders prior to a public listing, or when the shareholder wishes to sever connections with the company.

Both of these mechanisms require the trust to be provided with adequate funds to buy shares. Companies can make payments to the trust but are often deterred from doing so by the complex rules on corporation tax relief which can mean that no relief is granted. Consequently, the most popular mechanism is for the company to make a loan to the EBT, which is repaid when the EBT sells the shares on to another employee.

### 1.7 OVERSEAS EMPLOYERS

Foreign employers are permitted to offer tax-approved share plans to their UK employees provided that their shares are listed on a “recognised stock exchange”. While some larger non-UK employers do take advantage of this, there are some complications that discourage most from doing so.

The main complication is that the limits (for example, the £30,000 limit on approved option plans) are denominated in sterling, while the shares will be denominated in another currency. If exchange rates move unfavourably, a company might find that it breaches the limit unintentionally.

However, if the awards are much smaller than the limits (which might apply for example to a SIP that makes an award of £1,000 worth of shares rather than the full amount permitted) then this risk is small. There is still greater complexity in the calculations and reporting, but this is not too onerous.

Some UK companies also offer “shadow” approved plans to their non-UK subsidiaries, in the belief that a common approach around the world is desirable. These would technically be non-approved plans but may be capable of attracting favourable treatment in some countries, notably the US and France.

### 1.8 DISGUISED REMUNERATION

From 6 April 2011, a tax charge as employment income arises in respect of certain payments by third parties. Whilst primarily aimed at employee benefit trusts and employer-funded retirement benefit schemes, the potential reach of the legislation is much wider.

The tax legislation on employment income provided through third parties tackles arrangements which:

- involve third parties (including trusts or other vehicles used to reward employees), and
- seek to avoid or defer the payment of income tax.

Broadly speaking, if third party arrangements are used to provide for what is in substance a reward or recognition, or a loan, in connection with the employee’s current, former, or future employment, then an income tax charge arises.

The rules contain detailed exclusions. These prevent the legislation from catching certain arrangements. Generally, the exclusions are targeted at arrangements which are not tax avoidance arrangements.



If the legislation applies, it deems an amount to count as employment income.

The amount that counts as employment income is specifically brought within the scope of PAYE.

Detailed guidance is in HMRC's Employment Income Manual, beginning at -  
**<https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim45000>**.

### *Unfunded unregistered pension schemes*

The new rules will not apply to wholly unfunded unregistered pension schemes. However, if the employer (or a third-party) has earmarked assets to provide a pension then PAYE and NIC will be due when the earmarking occurs.

Where security is provided over assets held by the employer or another group company then the earmarking would be a relevant step, meaning that PAYE and NIC would be due when the security is given.

### *Existing funded unapproved retirement benefit schemes (FURBS) and employer-financed retirement benefit schemes (EFRBS)*

Pensions and lump sums out of EFRBS will remain taxable on distribution under the normal income tax rules.

Generally, no PAYE or NIC obligation will be due on investment income arising on funds already earmarked for former or present employees at the time this arises. This exemption will also cover any reinvestment suggested by an employee provided that no additional value is passed to the employee because of the arrangements. The investment return will normally be subject to PAYE and NIC when distributed to the employee or dependant.

The new rules mean that PAYE and NIC will apply if any new funds are allocated to employees after 5 April 2011.

Before 6 April 2006, EFRBS were known as 'non-approved' (or unapproved) retirement benefits schemes. These could be either funded (FURBS) or unfunded (URBS). The most obvious change in the tax rules for such schemes at 6 April 2006 was a change in the timing of when benefits were subject to tax. Whereas tax charges on FURBS typically arose at the time of funding a benefit, EFRBS charges typically apply only at the point of receipt of a benefit (as was also the case for URBS).

## 1.9 CASH ALTERNATIVES

Employers may offer employees a cash alternative to certain benefits. In particular this may be the case where the employee's remuneration package included the use of a company vehicle.

Where an employee has the option of giving up the use of a company vehicle in return for a cash payment, the tax treatment depends on the choice made by the employee. If the employee keeps the use of the company vehicle the benefit is taxed accordingly. If the employee gives up the vehicle and takes the cash, the cash will form part of the employee's remuneration for tax purposes.

NICs are also due on this benefit and the class of NIC paid will depend on what the employee actually receives. Where the employee takes the car Class 1A NICs are due and where he or she takes cash Class 1 NICs are payable.

Companies may also operate discretionary cash bonus schemes. The company may consider a discretionary cash payment where an employee does not wish to participate in an award of shares under a Share Incentive Plan (SIP). Although the trust deed, plan rules and share agreements must not contain any reference to bonus arrangements, it is acceptable to do so in employee communications such as booklets and online information.

Where the employee is awarded a discretionary cash payment it will be liable to tax under PAYE.

### Summary

There are important strategic reasons why companies choose to encourage employee share ownership. Only certain plans offer discretionary membership and those that do are typically used to reward key employees. Special plans (EMI) are available for small private companies.

Save As You Earn plans remain popular with employees due to their “low risk” features but Share Incentive Plans have overtaken them in popularity.

Despite the lack of tax breaks a company may choose to offer an unapproved share plan to reward employees. This is most relevant to senior executives and these plans usually link rewards to corporate performance.

All plans can be supported by an employee benefit trust to conserve shares and to allow private companies to operate share plans without losing control of their share register.

New rules surrounding disguised remuneration have tax implications for both employers and employees.

### Self Test Questions

- Why do many companies choose to encourage employee share ownership?
- What are the advantages of unapproved share plans?
- What is the limit on monthly savings under a SAYE share option plan?
- Why are SAYE plans perceived as lower risk than other types of employee share plan?
- What are the limits on shares that can be allocated under the Share Incentive Plan?
- What is the Income Tax position on exercise of an unapproved Share Option?
- Why would a public company establish an employee benefit trust?
- What are the tax implications of disguised remuneration?

# CHAPTER 2

## Flexible Benefits

### INTRODUCTION

This Chapter explains the different benefit options that can be included in a flexible benefits package. This is an important area to understand as more employers are looking to retain staff and enhance their benefit package without incurring significant extra costs and salary increases.

By the end of this Chapter students should be able to understand the key reasons for introducing a flexible benefits package, the different designs that can be offered, why good communication is key to provision of flexible benefits, the employment contract, tax issues that need to be considered, and how this works within an automatic enrolment environment.

### 2.1 WHAT ARE FLEXIBLE BENEFITS?

Flexible benefits plans are arrangements that allow employees to vary their pay and benefits packages in order to suit their personal requirements.

Many organisations have allowed a limited form of flexibility in the past for just one or two benefits, but over the last decade comprehensive flexible benefit schemes have started to become more common in the UK.

The concept of flexible benefits (also known as “cafeteria benefits” or “flex plans”) challenges the idea that it is appropriate to provide all employees in an organisation with an identical benefits package.

A company might, for example, provide every employee with:

- 25 days holiday
- Private medical insurance for the employee and spouse
- defined contribution pension plan
- life assurance of four times salary.

Flexible benefit packages acknowledge that employees are likely to have a different perception of value for each benefit depending on their attitudes, age, and personal circumstances. A young employee with no dependants might feel that life assurance is not necessary but value additional days of holiday. Another employee might have a spouse with personal (own or employer provided) private medical insurance and therefore, not need that cover. The company may have spent a considerable amount on providing these benefits but who gains if individuals do not need or value them?

Flexible benefits originated in the US, initially as a means of controlling rising healthcare costs and are now standard practice amongst employers there. It is a more recent concept in the UK, with a few schemes being launched in the 1980s but with a significant growth in the number of employers offering these schemes in the latter part of the 1990s. It is hard to give a precise number of flexible benefits schemes in existence though commentators suggest that around 1/3rd of medium and large sized employers in the UK may now offer these schemes.

Flexible benefits schemes usually grant a benefit value to employees which they can then choose to re-spend on benefits of their choice from the menu available. The employer will usually insist on a certain level of core benefits and offer freedom from the menu above these mandatory benefits. Should the employee want a greater mix of benefits than their benefit funding can provide then they can have these by reducing or sacrificing their salary. Those wanting fewer benefits can often increase their salary. In making their election, usually for the following year, the employee agrees to a variation to their contract of employment.

### 2.2 WHY INTRODUCE FLEXIBLE BENEFITS?

Usually there are specific issues that an employer wishes to address by the introduction of such a scheme so priorities will vary from one organisation to another.

The reasons for introducing choice into benefit programs vary significantly from company to company but the most common cited include the need for a competitive edge in recruitment and retention of staff, as a support to a more empowering corporate culture or to facilitate the harmonisation of benefits. Listed below are some of the advantages mentioned by employers that have implemented such a scheme. Some disadvantages are listed later.

#### 2.2.1 Choice

The cost of providing a benefit to an employee can vary hugely from the perception of value that the employee may put on the benefit. Employees will only perceive a value to a benefit if they see it as relevant to them. By being able to have a strong influence on how the money that the employer invests in benefits for an individual is spent the employee sees the benefits that have been chosen as more directly relevant and places a much higher perceived value on those benefits.

The choices afforded by flexible benefits can help meet the diverse needs of employees in several ways including:

- the ability to select from a wider range of different benefit options
- different sections of the workforce (e.g., young, married with family, single, etc.) can select benefits more relevant to them
- selections can change over time, usually annually, as personal circumstances change
- new benefits can be offered at little or no additional cost to the employer.

#### 2.2.2 Recruitment and Retention

Competitive pressures have been another driver of new flexible benefit programmes. In some industries, even at times of economic downturns, shortages of skilled staff have led to employers looking at ways to enhance the effectiveness of their reward package to help them compete for skills in the employment market. Offering flexible benefits can give a company a competitive edge in recruitment by allowing a recruitment candidate to see benefits on offer that better fit their own personal needs than those from employers with fixed benefits.

Offering employees choice means that the employer has to communicate the benefits package to employees to ensure that they have the knowledge to exercise that choice. This generally higher commitment to the communication of flexible benefits usually leads to an increased awareness of the benefits offered by the employer. This can aid retention, as staff have a greater understanding and appreciation of the additional value of their benefits package.

### 2.2.3 Cost Management

As the costs of benefits increase, something that has been particularly relevant to medical insurances, an employer offering fixed benefits has little option but to absorb that increase. Where a flexible benefit scheme exists, the employer has the option of sharing cost increases at renewal with the employee. For example, if a benefit cost £400 a year and at renewal it increases to £500 the employer could decide to limit the extra benefit funding given to employees to, say, £60 and have members who continue to elect that benefit pay the further £40.

It is a way of introducing new benefits at little cost to the employer because employees purchase them by reducing their own salary. In addition, the employee gains because a large employer can use its purchasing power to secure attractive discounts. This could mean benefits such as travel insurance or health club membership could be offered at a significantly lower cost than typical “high street” rates.

The use of a flexible benefits scheme makes it less likely that the employer is spending money on providing benefits that are not valued.

Cost savings can also arise from NIC savings for the employer. If employees elect to forgo salary in favour of a benefit that is exempt from employer’s NICs, in other words a benefit that does not need to be declared as a benefit in kind for the employees’ tax purposes, then the employer’s overall NIC bill will reduce. The employer avoids paying NIC contributions (13.8% in 2023/24) on the salary being given up by the employee. Example of this type of benefit can include pension contributions, dental insurance, and bicycles under a cycle to work scheme.

Note: Care is needed to ensure that the HM Revenue & Customs (HMRC) are satisfied with any arrangements put in place. Salary Sacrifice is dealt with in more detail in Part 3, Chapter 3.

### 2.2.4 Harmonisation of Benefits

The harmonising of benefits is always an issue that arises following mergers and acquisitions. Employers have to deal with, for example, one group of employees with benefits A, B, and C and another group who have benefits B, C and D. In a fixed benefit environment to harmonise benefits the choice is either to remove one or more benefits from some of the employees or to pay the cost of providing all the benefits. With a flexible benefit scheme, the employer can make all the benefits available to all employees but make it the employee’s individual choice as to which benefits he wishes to have. The company will still be making the same benefit value available to employees as they were before the merger.

### 2.2.5 Culture Change/Enforcement

Flexible benefits can help reinforce an organisation’s culture or help support a cultural change that is occurring. The concept of flex is to empower employees to take responsibility for their own decisions and as such often is used in an environment where the employer’s culture is moving from a parental instructional ethos to one of employee responsibility. It can also support a desire to be seen as an innovative company.

### 2.3 DISADVANTAGES OF FLEXIBLE BENEFITS

A flexible benefits scheme is not automatically the right choice for every company. If it does not fit the organisation's culture and reward strategy and support the company's strategic business objectives, then it would be totally wrong to offer a flex scheme. Employers may also have other concerns about introducing a scheme. These concerns include:

- the complexity and costs involved to set a scheme up
- the administration burden resulting from offering staff a complex range of benefit choices
- the risk that employees, without specialist advice, will make unsuitable benefit choices, e.g., opting out of life cover and leaving their family with inadequate protection
- the commitment to employee communication that is needed with flex
- the risk of selection against insurers – where employees are given freedom to decide whether or not to have a benefit and at what level, this can lead to higher insurance premiums
- the need for scale – a small organisation employing a handful of people may not have the buying power to secure attractive terms for benefits and the costs of implementation may outweigh the perceived advantages.

Most of these issues can be overcome by proper planning and with the aid of specialist advice. Administration, which has arguably been the biggest barrier, has become far less cumbersome in recent years with the development of the latest generation of web-based administration systems.

### 2.4 DESIGN OF FLEXIBLE BENEFIT SCHEMES

Every employer has different aims and objectives for its flex scheme. The employee mix and culture varies from employer to employer. Due to this it is very important that each scheme is designed to meet the needs of that particular employer. Set out below are some of the issues that need to be taken into account in the design of a scheme.

#### 2.4.1 Eligibility

Before introducing a flexible benefits plan, employers should decide which employees will be invited to participate. In looking at this there are legal constraints such as age and sex discrimination legislation that has to be taken into account.

Some of the earlier flex schemes were offered to management groups or just salaried staff. More recent experience shows that majority of modern schemes tend to include their full employee group in a scheme. Although there can be additional issues that need to be addressed in including blue collar groups in a scheme, for example the practicalities of offering flexible holidays in a three-shift manufacturing environment, more often than not employers will look to introduce flex to all employee groups (the corporate cultures that will be more attracted to flex tend to be those that work inclusively with all levels of employee).

#### 2.4.2 What benefits could be included?

A flex scheme can be viewed as simply a distribution channel that coordinates the delivery of an employer's benefit program to its staff. As such any benefit can be delivered through the scheme.

The choice of which benefits to include will vary from employer to employer. Some companies run Voluntary Benefit schemes alongside their flex scheme and feel that certain of the items are better delivered through their VB environment where others totally integrate their voluntary benefits as part of their flex scheme.

## Reward and Retirement Provision

A typical flexible benefits scheme will include benefit options that existed previously, either as a mandatory or elective benefit, plus a number of other additional options. Usually, these additional options are offered for employees to “buy” so are cost neutral to the employer. Often a new scheme will start with a limited number of benefits, say ten or 12, and the options gradually increased over time.

Below are some benefits that can be found in flexible benefit schemes. These lists should not be viewed as exclusive:

Frequently Offered	Other Possible Options
Flexible annual leave/holiday	Bus passes
Pension	Share options
Life assurance	Salary Sacrifice cars
Personal accident cover	Wine Club
Long term disability	Professional fees
Medical insurance	Life cover on spouse/partner
Critical illness cover	Learning accounts
Company car	Luncheon vouchers
Travel insurance	Sabbaticals
Childcare vouchers	Retail vouchers
Dental insurance	Discount cards

### 2.4.3 Structure

There is no set way that a flexible benefit should be designed but there are two main styles of scheme that tend to dominate UK flex scheme design.

The first of these is a **Total Remuneration** structure. Under this style of scheme employees are given one figure that represents the total of the value of their cash reward (salary) and benefits. This may be described as their Flex Fund or Remuneration Package. In making their flex choices the cost of any core benefits is then deducted from this amount followed by the cost of the benefits that the employee elects for from the flex scheme. The balance is the employee’s cash salary for the coming period.

An illustration of this may be:

Flex Fund/Total Remuneration			£ 40,000
Core Benefits			
Life Assurance	£ 100		
Self for Private Medical	£ 400		
Minimum pension	£2,000		
		£ 2,500	
Elected benefits			
Critical illness	£ 200		
Travel Insurance	£ 50		
Family Private Medical	£ 600		
		£ 850	
			£ 3,350
Cash Salary			£ 36,650

## Reward and Retirement Provision

The other main style of scheme is where the salary remains the same and the amount of money being provided for benefits is identified as a separate Benefit Fund. This may have the value of core benefits included within it or as a separate figure. Employees then make their benefit selections. If they spend more than the benefits value, the difference is taken as a reduction to salary. If they spend less than their benefit value, the difference comes to them as a supplement to salary.

This is illustrated below:

Benefit Fund			£ 4,000
Core Benefits			
Life Assurance	£ 100		
Self for Private Medical	£ 400		
Minimum pension	£ 2,000		
		£2,500	
Elected benefits			
Critical illness	£ 200		
Travel Insurance	£ 50		
Family Private Medical	£ 600		
		£ 850	
			£ 3,350
Supplement to salary			£ 650
Salary			£ 36,000
Cash Salary			£ 36,650

As can be seen to the employee the main difference is presentational. One significant difference however is that the levels of salary related benefits, for example life assurance, is usually calculated on the total Flex Value on the Total Remuneration basis and the Salary for the Benefit Fund basis.

### 2.4.4 What choices to give?

When creating the structure of a flexible benefits programme, decisions must be made concerning:

- the benefits to include
- the number of different options available for each benefit
- which, if any, of the benefits should be core benefits.

#### *The number of benefits to include*

Flex schemes in their launch year have a tightrope to walk when deciding on the number of benefits to include. There need to be enough benefits that the scheme will appeal across its membership demographics but not so many that there is so much information to communicate that employees will be turned off by information overload.

#### *The Number of Options for Each Benefit*

Decisions here might include whether or not to allow an employee to extend cover to his partner and/or family. In addition, most benefits, for example life assurance, critical illness and dental insurance might have different levels of cover. The flexible benefits plan could include all of the options available or simply just offer one level.

As always, companies will need to strike an appropriate balance between offering choice and keeping the scheme easy to understand and administer.



### 2.4.5 Core Benefits

Core benefits are benefits that the flex schemes design mandates that an employee must maintain as a minimum part of their package.

There are practical reasons for an employer to impose a core level of benefit. These include benefits where an employer feels that it would be poor employment practice to let an employee opt out altogether. An example of this may be Life Assurance where allowing an employee to opt out altogether could lead to the situation of a newly bereaved widow being told there is nothing to be paid, something that could cause ill will in the workforce.

Another reason for insisting on a benefit is where its inclusion supports a need of the business. An example could be where a firm of solicitors may want to ensure that its fee earners are covered for private medical insurance.

There may be current or anticipated statutory reasons to mandate a benefit. Minimum levels of holiday under the Working Time Directive are a current statutory requirement. An example of an anticipated statutory requirement, at least for some companies, is minimum pension contributions through “automatic enrolment”. This started to come into force in October 2012 and was introduced gradually, starting with the largest companies (see 2.5.3). Because of this it would be unwise not to mandate a core level of pension contribution.

A further reason for mandating particular benefits may be driven by the market from which individual benefits have to be procured by the employer. An Employee Assistance Programme (EAP) is one example. If purchased for a whole workforce EAPs can be purchased for a very low cost. If, however this is made available on a free choice basis the cost can increase by, for example, possibly six fold. This may well cause the employer to include this as a core benefit. Other examples of this are Life Assurance where if a minimum level of cover is mandated low-cost unit rates and elements of cover free from underwriting may be available but without the minimum only age-related rates all subject to underwriting may be all that is on offer from the market.

### 2.4.6 Pricing Benefits

There is no reason why the cost charged for a benefit needs to be the actual price that the employer is paying the provider. There are a number of different approaches to pricing that can be taken for each benefit:

- charge actual cost charged – typical for many medical and insurance-based benefits
- charge a price less than the cost – often seen to apply to the tax efficient benefits where the employer may share part of their National Insurance savings with the employees. Common examples are pension contributions and dental insurance
- behavioural pricing – charging employees a higher or lower cost of a benefit to encourage or discourage employees from taking that benefit.

For a number of benefits there is the added complication that the cost charged to the employer is not truly reflective of the value to an individual employee. An example is Life Assurance where the employer is charged on a unit rate basis which assumes the average age of the membership. Some schemes may construct an age-related charge to employees to target the cost to be closer to the value to the employee. More complex pricing decisions need to be made around defined benefit pension schemes in flex where the cost shown to the employee may be age related, related to the future service element of the funding rate and influenced by the employer’s future plans for the pension scheme.

### 2.5 FLEXIBLE BENEFITS AND PENSIONS

Many companies that offer flexible benefit packages incorporate their pension scheme into the arrangement.

The reasons why a company may wish to include pensions in a flexible benefits arrangement are:

- it helps the employer give a holistic presentation of the company's overall employee benefit package
- it is necessary if the flex scheme is to communicate a Total Reward to employees
- often companies use flex as a delivery method to receive the financial benefit from "Smart" or Salary Sacrifice pensions (see Part 3, Chapter 3).

The approach taken is likely to vary according to whether the scheme is defined benefit or defined contribution.

#### 2.5.1 Defined Benefit Schemes

The options that an employer may make available under a DB scheme could be:

- different accrual rates for different levels of contribution – e.g., just paying the normal scheme contribution of say 5% the member will get a 60ths accrual rate, but if the member pays 10% the accrual rate is a 55th
- Voluntary top up
  - DC
  - DB "Added years".

However, if the pension scheme is to be included in the flexible arrangement there are a few things that the employer and the trustees of the scheme will need to consider. These include:

- Whether the scheme rules permit the options considered under the flexible benefits arrangement. For example, if the member chooses to take advantage of the option to increase their accrual rate, do the scheme rules provide for this? This could involve a costly change to the scheme rules and the time-consuming communication and consultation exercises involved in this.
- Administration issues – are the administrators and their systems able to cope with the added flexibility? If they can, are they likely to charge more for the additional options?
- The cost is very age related i.e. the older the member, the higher the cost.
- Age discrimination issues.

#### 2.5.2 Defined Contribution Schemes

The types of options that may be available under the defined contribution arrangement are:

- Increase/decrease contributions e.g., the core level is 5% of basic pay but there is an option to increase this in 1% increments to a maximum of 10%.
- The ability to select the funds that the core and additional contributions are invested in.

The considerations for the employer and the trustees are similar to those under a DB arrangement.

#### 2.5.3 Automatic Enrolment

With the introduction of automatic enrolment from October 2012, employers need to decide how they will meet their duties to enroll jobholders into an appropriate pension scheme from their automatic enrolment date. This might be done through using an existing scheme which meets the minimum contribution/benefit requirements or by setting up or selecting a new scheme specifically designed to meet the requirements.

The Pensions (Extension of Automatic Enrolment) (no. 2) Bill has passed the second reading and is now at the committee stage (July 2023). This Bill permits two extensions to Automatic Enrolment – abolishing the LEL for contributions and reducing the age for being automatically enrolled to 18 years old.

The Pensions Regulator has issued detailed guidance for employers, which includes the use of flexible benefit packages. This says that pension schemes within a flexible benefits package can meet the requirements for automatic enrolment provided they comply with the underlying employer duties.

## Reward and Retirement Provision

This means that an eligible jobholder (or jobholder who has chosen to opt in) must be enrolled into the scheme at or above the relevant minimum contribution level (i.e., 8% in total following the end of the transitional period in 2019/20), even if the jobholder has not made any specific election regarding his or her flexible benefit options. Once the jobholder has been enrolled with effect from the automatic enrolment date, he or she may reduce or increase the level of contributions paid in accordance with the rules of the flexible benefits arrangement and the scheme.

However, care needs to be taken in the benefit design in flexible benefits schemes as the Pensions Regulator has made it clear that when offering flexible benefits scheme the purpose must not be to induce employees to opt out of a qualifying pension scheme.

### 2.6 LIFETIME INDIVIDUAL SAVINGS ACCOUNT (LISA)

The Lifetime Individual Savings Account (LISA) was introduced in April 2017 in order to “help young people to simultaneously save for a first home and for their retirement”. The following illustration of how the LISA works was provided by the Government – A comparison of the new LISA against other forms of longer-term savings vehicles is provided below.



Option	Annual Contribution Limit	Tax Treatment	Access	Purpose	Employer NI Liability
<b>Pension</b>	Tax relief up to £60,000 pa. Tapered reduction to £10,000 if earning greater £260,000 pa (2023/24)	<b>EET</b> Tax relief on contributions, tax privileged growth, 25% of fund tax-free on withdrawal, remainder subject to income tax	From age 55	No restriction	No
<b>Workplace ISA</b>	£20,000 (2023/24) (LISA contributions will count towards ISA allowance)	<b>TEE</b> Contributions from after tax pay. Tax privileged growth, tax-free withdrawals	Anytime	No restriction	Yes
<b>LISA</b>	£4,000 pa. Must be under age 40 to open a LISA. Contributions must cease after age 50.	<b>TEE + Bonus</b> Contributions from after tax pay receive 25% Government bonus. Tax privileged growth, tax-free withdrawals.	From age 60 or to purchase first property. Other withdrawals forfeit. Bonus and subject to 5% penalty.	Before age 60 – property purchase. After age 60 no restrictions.	Yes

Individuals may choose a LISA (or other ISA) over, or in addition to, their workplace pension. Whether they do so will depend on a number of factors, such as:

- **Eligibility** - LISA may be attractive before being eligible for automatic enrolment or if membership of a registered pension scheme would result in loss of HMRC 'protection(s)'.
- **Affordability** - in particular, whether an individual is able to contribute to both.
- **Existing savings** - e.g., LISA may be attractive to those at risk of exceeding the Annual or Lifetime Allowance.
- **Tax rates** - in work and in retirement e.g., many individuals may be higher rate taxpayers in work (with marginal rate relief on pension contributions) but basic rate taxpayers in retirement.

The key consideration, however, will generally be the availability of an employer contribution. Employer contributions to workplace pensions mean that, on pure financial grounds, pensions generally provide a better outcome).

Of course, contributions to a LISA do not currently exempt an employer from having to automatically enroll workers into a qualifying pension scheme. Nevertheless, one option for employers that want to provide employees with a choice, whilst ensuring compliance with workplace pension duties, would be to provide a 'flexible savings allowance'. Part of this would have to be paid into a qualifying pension scheme but the remainder could be used for other forms of saving (such as a LISA) or taken as cash, net of tax and NI. By putting in place a 'workplace LISA', it might also be possible to obtain preferential terms from the provider.

Whether employers would be willing to contribute to a pension and to another savings vehicle may depend on their workforce demographic and corporate philosophy. Employers' reward strategies are usually devised, at least in part, to attract and retain the best employees. If an employer has a workforce that is typically made up of younger people, then a workplace pension may not be a priority for them whereas help getting on the housing ladder and paying off a mortgage or other debt more quickly could be very attractive.

Conversely, in an era where compulsory retirement is often unlawful, employers have a vested interest in ensuring that their employees are saving enough for retirement. Pension saving could be vital if individuals are to be able to retire at a time which suits them and their employer, and on an income that provides them with a decent standard of living.

As mentioned above, the LISA does not necessarily replace pensions. Long term savings schemes with different tax regimes already exist in the US. For those that can afford to save into both a pension and a LISA (or other ISA), they will benefit from a very effective and versatile long-term savings strategy that could help them to buy a home, pay down/off debt and provide an income in retirement.

For completeness, it is also worth mentioning that many people still believe that the LISA is a precursor to pensions becoming more like ISAs (where there is no up-front tax relief, but benefits are tax free). So, ISA type savings schemes in the workplace may yet become the norm.

### 2.7 COMMUNICATION

If the communication of benefits is important for fixed benefits, it is of even greater importance in the flexible benefit environment. This is because flex empowers employees to make choices and it is only through good supportive communication that employees can make true informed choices.

Communication should take place at every stage of the lifecycle of a flex project. A communication strategy for flexible benefits should address four key stages:

### *Stage 1 – Initial Research*

Input from employees to the design of the scheme will help ensure that particular wants among the workforce can be addressed when shaping the scheme. Focus groups could be used to help establish those elements of the existing package where greater flexibility is sought and the new benefits people would like to see. It is important that any focus group is representative of employees generally and that expectations are managed.

Views on how the rest of the communication could be most effective could also be sought from this group.

Feedback should be given to those who participate so that they feel they have been listened to, even if some of their ideas are not subsequently implemented.

### *Stage 2 – Pre-Launch*

The objective is to ensure the communication methods planned are appropriate. This may be part of any pilot exercise or using focus groups and can include:

- testing enrolment forms for ease of completion
- ensuring those that will brief others on the programme (e.g., HR staff or line managers) are fully trained
- checking how messages have been interpreted by staff, to avoid any misunderstandings on launch.

It is also an opportunity to raise the profile of the scheme prior to launch.

### *Stage 3 – The Launch*

A successful launch should mean that all employees clearly understand:

- why the programme has been launched and how it will benefit them and the company
- what benefits and options are available
- how they make their own personal choices (some worked examples may help)
- when they have to complete their enrolment by and what happens after that.

There is a range of media that can be used to assist with the launch including newsletters, email, intranet/ internet sites, CD-ROMs and noticeboards. However, face-to-face communication is generally seen as the most effective way of delivering the message and making sure that employees' questions are properly addressed.

A critical element of communicating flexible benefits successfully is the enrolment process. Employees should find it easy to understand how their existing benefits have been priced and the cost of selecting different options. It is particularly important that individuals know how to assess the impact on pay of each option.

### *Stage 4 – Review*

Having implemented a programme, it is essential that feedback is sought from employees. Questionnaires or focus groups can help to determine:

- the success (or otherwise) of the existing communication strategy
- the popularity of the benefit options provided. For example, are there any options with a low take-up and, if so, why?
- What options would employees like to see for the future?

### 2.8 TAX CONSIDERATIONS

From a tax perspective a flexible benefit scheme is a method of delivering a range of benefits to an employee. These will typically be by way of Salary Sacrifice. Unlike a pension scheme, there is no separate area within the HMRC dedicated to the approval/registration and monitoring of flexible benefit packages. Instead, a company wishing to introduce a scheme would obtain clearance from the local tax inspector once the plan is in place. This clearance is to confirm that any salary sacrifice arrangements under the scheme are effective.

Apart from ensuring that the salary sacrifice is properly structured, the other interest that the tax authorities have in the scheme is the way that the individual benefits are treated for Benefit in Kind purposes.

If an employee receives something in a non-cash form their employer has to declare these to HMRC as a Benefit in Kind and the employee will have to pay Income Tax on the amount of the benefit. Employers have to pay class 1a National Insurance Contributions on the amount of this taxable benefit, but the employee does not have to make any NI contribution.

Some benefits can be provided to an employee without them having to be declared. This is usually because there is specific legislation in place allowing this. Examples of these benefits that do not give rise to a Benefit in Kind tax liability include:

Registered pensions	Bus schemes
Life Assurance	Car parking schemes
Cycle to Work Schemes	Workplace nursery provision

There are other component benefits included in flex schemes that have a partial tax advantage where there are specific rules that say how they must be declared. An example of this is car schemes through flex where the benefit in kind value is declared based on the specific tax rules applying to company cars.

### 2.9 CONTRACT OF EMPLOYMENT IMPLICATIONS OF FLEXIBLE BENEFITS

As was explained earlier most modern flexible benefit schemes are a collection of salary sacrifice arrangements. Under these types of schemes, so long as contractual benefits are maintained as the default benefits, there is no specific need to change contracts of employment as each employee, when making their flex election, is requesting a variation of contract.

Many employers do however decide to change the contracts of employment to embed the flex scheme within them. Any changes to existing contracts need to be identified early and legal advice sought to ensure compliance with employment law. Areas to consider include:

- equal pay legislation needs to be observed to avoid charges of discrimination against specific groups, such as part timers.
- trade unions may need to be consulted if existing terms and conditions have been agreed collectively
- under the Employment Rights Act 1996 employers cannot make deductions from employees' pay without consent. Employees' agreement to any changes to their contract of employment and any benefit choices will need to be properly documented to comply with this legislation and to avoid any disputes later.

If an organisation is looking to make significant changes, perhaps discontinuing an existing benefit, then great care is needed. Even if a company is meeting its legal obligations, such changes will be poorly received if employees believe that the introduction of flexible benefits will mean that they are worse off.

### Summary

This Chapter aims to describe the basic principles of flexible benefits:

- There are a number of different reasons why a company may choose to introduce flexible benefits.
- Issues that must be addressed before a scheme can be introduced include which benefit options to include, who should be covered and whether core benefits should be included.
- The “Core” plus options approach is a very common design of flexible benefit schemes.
- Tax and National Insurance issues will impact on the design of a scheme.
- The importance of good communication cannot be underestimated. This is an important issue before and after the introduction of a scheme.
- Flexible benefits involve tax and employment issues that must be considered by employers and employees.
- Changes to employment contracts need to be reviewed to ensure compliance with employment law.

### Self Test Questions

- Outline the key reasons why an employer might choose to introduce flexible benefits.
- Identify the potential disadvantages of implementing a flexible benefits scheme?
- List five common benefit options included in a flexible benefits plan.
- Outline the reasons why companies include core benefits and give two examples of why this is good practice.
- Describe the possible reasons for imposing a core level of benefits.
- How do automatic enrolment requirements need to be taken into account?
- An employer has hired you to assist with the introduction of a flexible benefits plan, how would you explain the differences between the two main styles of flexible benefit structures to him?
- An employer is considering setting up a flexible benefits plan and would like to fully engage its employees. How would you communicate this to employees in order for them to understand the benefits?

## CHAPTER 3

# Salary and Bonus Sacrifice

### INTRODUCTION

This Chapter explains the basic details of salary and bonus sacrifice, identifying the potential savings in National Insurance Contributions (NICs) that can be achieved for both the employer and employees. This is an important concept to grasp as a large number of pension schemes are adopting such arrangements as a way of reducing the cost of providing benefits to members. By the end of this Chapter, you should be able to understand how salary sacrifice works, the potential savings on offer and important other points to consider if you are involved in implementing such a scheme.

Significant reforms were made to salary sacrifice with effect from 6 April 2017. From 6 April 2017, special rules determine the amount of a benefit treated as earnings from the employment where the benefit is provided as part of 'optional remuneration arrangements'. Optional remuneration arrangements are arrangements where an employee gives up the right, or the future right, to salary (commonly called salary sacrifice or salary exchange) or the right to some other form of cash remuneration in return for the benefit. They include flexible benefit packages with a cash option.

Where a benefit is chosen instead of some form of cash pay, the taxable value of the benefit and the amount liable for National Insurance contributions is the greater of the:

- amount of salary or cash pay foregone, and
- taxable value of the benefit under the normal benefit in kind rules, ignoring any amount made good

For most benefits, where those benefits are provided through optional remuneration arrangements the existing tax exemptions don't apply from 6 April 2017. The following benefits aren't affected by the new rules:

- payments by employers into registered pension schemes
- childcare vouchers, workplace nurseries, and directly contracted employer provided childcare
- bicycles and cyclist safety equipment (including Cycle to Work)
- Ultra-Low Emission Cars (ULEVs) with CO<sub>2</sub> emissions of no more than 75g per kilometre that are in the scope of the car benefit charge
- payments and benefits connected with taxable cars and vans

Transitional provisions apply for a limited period. Subject to certain specific exceptions, optional remuneration arrangements entered into before 6 April 2017 continue under the normal benefit rules until the earlier of:

- variation, renewal (including auto-renewal) or modification of the arrangement, and
- 6 April 2018.

Those exceptions are cars with CO<sub>2</sub> emissions of more than 75g kilometre, living accommodation and school fees.

Detailed guidance is available at – [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/785476/480\\_2019\\_Expenses\\_benefits.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785476/480_2019_Expenses_benefits.pdf).



### 3.1 WHAT IS SALARY SACRIFICE?

A “salary sacrifice” is an arrangement where an employee waives their contractual entitlement to part of their cash pay, in exchange for a non-cash benefit provided by their employer. The salary sacrifice is achieved by varying the employee’s contract of employment and as such falls under employment law rather than tax law.

“Bonus sacrifice” is a specific type of salary sacrifice, where an employee sacrifices all or part of a bonus payment, rather than part of their regular salary or wage. Since there is no legal or conceptual difference between the two (except salary sacrifice is ongoing and the bonus sacrifice is one off), we will refer to both as salary sacrifice.

The most common salary sacrifice arrangement is where the employer pays a corresponding amount into a registered pension scheme instead of member contributions. The payment is thus an employer contribution to the scheme, which does not attract NICs.

Salary sacrifice can also be used in relation to other benefits such as:

- Childcare vouchers
- Workplace nurseries
- Loaned cycles and cyclists’ safety equipment
- Private medical insurance and many other benefits.

(But see the comments above about changes that took effect from 6 April 2017.)

However, if a wide range of benefits are being offered it will usually be via a full flexible benefits plan.

### 3.2 REASONS FOR ADOPTING SALARY SACRIFICE

The main reasons for an employer introducing a pension salary sacrifice are:

- to promote take up of the pension scheme, particularly amongst employees earning below the Upper Earnings Limit (where the NIC savings are greatest)
- to assist with recruitment and retention of key staff by making membership of the pension scheme more attractive
- to provide a platform for the introduction of a full flexible benefits package, and
- to take advantage of the employee and employer NIC savings that arise in order to reduce the increasing cost of pension provision.

In a salary sacrifice arrangement, employers pay a reduced level of salary to employees, but also pay an equivalent contribution into the pension scheme. The employer makes a NIC saving because they do not have to pay NICs on employer pension contributions, but they would have had to pay NICs on salaries. Employees see a reduction in their gross annual salary equal to the contributions sacrificed. This means that they pay NICs on a lower salary. In addition, the employer pension contribution in respect of the employee is not subject to NICs from the employee, so overall the employee makes a NIC saving as well.

In reducing the cost, lower paid employees can benefit as they might perhaps otherwise not be able to afford to pay contributions at the required level, and so would not join the scheme or would opt out. The level of NIC saving is also greater for lower paid employees (specifically employees earning under the Upper Earnings Limit) and hence this enables schemes to promote take-up amongst lower paid employees.

### 3.3 CRITERIA TO BE AN EFFECTIVE SALARY SACRIFICE

To be an effective salary sacrifice arrangement, the contractual right to cash pay must be reduced. This is achieved when:

- the right to potential future cash payments have been surrendered before being treated as received for tax or NIC purposes
- the employee is genuinely entitled to a lower cash payment and an added benefit under the revised contractual arrangement.

The position for company directors is more complicated, since their remuneration may be treated differently to normal employees, and it is not immediately clear at what point the salary or bonus is deemed to be received. Any salary sacrifice for a director should therefore be referred to the employer's tax advisers.

### 3.4 EXAMPLES OF EFFECTIVE SALARY/BONUS SACRIFICE

#### Example 1

An employee, who is not a director, earns a salary of £30,000 per annum. They are paid monthly and entitled to 1/12th of their salary (£2,500) on the final day of the month. The employer operates a DB pension scheme and decides to introduce a salary sacrifice arrangement for employee pension contributions from 1 December 2009. Employee contributions are 5% of salary, so are equal to £125 per month for this employee.

Prior to the last day in December (the date the first salary payment is paid under the salary sacrifice arrangement), the employee agrees to give up part of their salary equivalent to the employee pension contributions they would otherwise have paid. From the 31 December 2022 pay date, the employee is paid only £2,375 per month (i.e. £2,500 less the £125 sacrifice).

This is an effective salary sacrifice since:

- the employee has agreed to reduce their cash pay before 31 December, when the payment would become taxable as employment income, and
- the true construction of the revised contractual arrangement between the employee and employer is for a reduced cash payment in exchange for an equal level of employer pension contributions.

#### Example 2

An employee, who is not a director and has a contractual annual bonus of £10,000 per annum, which is based on the profits of the employing company. Their employer operates a DC pension scheme with a salary sacrifice arrangement for employee pension contributions.

The bonus is announced on 1 July every year, but is not paid until 31 August.

The employer writes to the employee informing them of the awarded bonus and offering the choice of either taking the whole bonus as cash, giving up her contractual right to the entire bonus in exchange for an equivalent employer pension contribution to her DC pot, or an equivalent combination of cash and employer pension contribution. It is also made clear that the employee will not have the right to change their decision once it has been made. The employee decides to sacrifice their whole bonus.

This is an effective sacrifice provided that:

- the employee completes and returns the completed documentation before 31 August, and
- the revised contractual arrangement between the employee and employer is in respect of a one off £10,000 reduction in cash payment and additional employer pension contributions of £10,000.

### 3.5 SCHEME DESIGN CONSIDERATIONS

Take-up is the key to an effective salary sacrifice arrangement. If few employees choose to participate, then the costs of setting up the arrangement may outweigh the savings achieved. Effective communication of the changes is important so that employees understand the changes and will buy in to the benefits of participating.

When designing a salary sacrifice arrangement, consideration should be given to the following items:

- **Salary definitions:** Since salaries are being reduced there are implications for benefits provided by the company which are related to salary and pension benefits which are based on the salary received. To avoid any immediate benefit loss to employees the salary definitions used by both the company and under the pension scheme Trust Deed and Rules would need to be amended, to allow for a salary sacrifice arrangement. It is common that the employer will want to base both pension and other employer provided benefits related to salary on the full (pre sacrifice) salary, and so the salary definitions would need to be amended to refer to this notional salary.
- **Refund of contributions:** Many occupational pension schemes pay a refund of employee contributions, either on leaving a scheme with less than two years' service, or on the death of a member before retirement. Under a salary sacrifice arrangement, the employee contributions become employer contributions, and so a refund of employee contributions will yield nothing to the employee. It might be possible to change the scheme rules for death benefits so that the benefit pays out an amount equivalent to the contributions the member would have paid if they had earned the notional salary. For withdrawals, the corresponding payment would be unauthorised and so would not usually be a viable option. The employer could consider making ex gratia payments to members in these circumstances. It is also worth noting that members of occupational defined contribution pension schemes who leave an employer after less than two years of service will no longer be able to take a 'short service refund' of any contributions they have paid into that scheme from October 2015. The change will only apply to employees who join a DC occupational pension scheme from October 2015.
- **Opt in or opt out:** When setting up a salary sacrifice arrangement, there needs to be a default option for members who do not respond to communications. Adopting a default position of moving to the salary sacrifice arrangement, with the option to opt out is likely to lead to a higher take up than having a default position of keeping things unchanged with the requirement to opt into the salary sacrifice arrangement.
- **Share the NIC saving:** The employer needs to consider whether it wishes to pass any of the employers NIC saving onto employees. It could do this by paying enhanced contributions over and above the salary sacrificed to a DC scheme, or by enhancing some benefits in a DB scheme.

Whether any saving is passed onto employees may depend on the proportion of members earning above the Upper Earnings Limit (where the employee NIC savings are lowest) and the likely take up rate of the salary sacrifice arrangement.

Where salary sacrifice is operated across a company, the savings, bearing in mind that they apply year after year, can be significant.

## Reward and Retirement Provision

### Example

A company has 250 employees in its money purchase pension scheme. The employees currently pay 5% of salary as a contribution, but the company decides to introduce an automatic salary exchange scheme. Consequently, the pension scheme becomes non-contributory (with the employer increasing its payments to counteract this) and members' salaries are reduced.

The 'before and after' position (assuming, for simplicity, that all members earn £30,000 a year (before salary exchange); basic rate tax is payable on all taxable earnings; and 2023/24 thresholds for tax and NI thresholds apply) is as follows:

Before Salary Exchange	After Salary Exchange
Total Gross Salaries – $£30,000 \times 250 = £7,500,000$	Total Gross Salaries – $£28,500 \times 250 = £7,125,000$
Total member pension contributions – $£7,500,000 \times 5\% = £375,000$	Total member pension contributions – Nil (but increased employer contribution)
Total Personal Allowance (assume everyone gets single person allowance) – $£12,570 \times 250 = £3,142,500$	Total Personal Allowance (assume everyone gets single person allowance) – $£12,570 \times 250 = £3,142,500$
Total Income Tax payable – $[(£7,500,000 - (£375,000 + 3,142,500))] \times 20\% = £796,500$	Total Income Tax payable – $(7,125,000 - £3,142,500) \times 20\% = £796,500$
Employee NI – $(£30,000 - £12,570) \times 250 \times 12\% = £522,900$	Employee NI – $(£28,500 - £12,570) \times 250 \times 12\% = £477,900$
Employer NI – $(£30,000 - £9,100) \times 250 \times 13.8\% = £721,050$	Employer NI – $(£28,500 - £9,100) \times 250 \times 13.8\% = £669,300$
Total take home pay – $£7,500,000 - £375,000 - £796,500 - £522,900 = £5,805,600$ (i.e., £23,222.4 per employee)	Total take home pay – $£7,125,000 - £796,500 - £477,900 = £5,850,600$ (i.e., £23,402.40 per employee)
	Total NI saving – $(£522,900 - £477,900) + (£721,050 - £669,300) = £96,750$ for one year)
	NI saving breakdown – Employer saving = £51,750 (i.e., £207 per person) Employee saving = £45,000 (i.e. £180 per person)

### 3.6 TAX IMPLICATIONS AND NIC SAVINGS

This section looks at the implications of adopting salary sacrifice on the amounts of Income Tax and NICs payable.

Income Tax Rates and Thresholds for 2022/23 Tax Year (note that there are different rates in Scotland and the rest of the UK)

#### England and Northern Ireland

PAYE tax rates and thresholds	2023 to 2024
Employee personal allowance	£242 per week £1,048 per month £12,570 per year
English and Northern Irish basic tax rate	20% on annual earnings above the PAYE tax threshold and up to £37,700
English and Northern Irish higher tax rate	40% on annual earnings from £37,701 to £125,140
English and Northern Irish additional tax rate	45% on annual earnings above £125,140

#### Scotland

PAYE tax rates and thresholds	2023 to 2024
Employee personal allowance	£242 per week £1,048 per month £12,570 per year
Scottish starter tax rate	19% on annual earnings above the PAYE tax threshold and up to £2,162
Scottish basic tax rate	20% on annual earnings from £2,163 to £13,118
Scottish intermediate tax rate	21% on annual earnings from £13,119 to £31,092
Scottish higher tax rate	42% on annual earnings from £31,093 to £125,140
Scottish top tax rate	47% on annual earnings above £125,140

#### Wales

PAYE tax rates and thresholds	2023 to 2024
Employee personal allowance	£242 per week £1,048 per month £12,570 per year
Welsh basic tax rate	20% on annual earnings above the PAYE tax threshold and up to £37,700
Welsh higher tax rate	40% on annual earnings from £37,701 to £125,140
Welsh additional tax rate	45% on annual earnings above £125,140

In addition, if an individual earns over £100,000, their personal allowance of £12,570 is reduced by £1 for each £2 of income over £100,000. This means that there is an effective marginal Income Tax rate of 60% between £100,000 and £125,140 for a UK taxpayer.

Take an individual earning £36,000 per annum who is participating in a DC pension scheme and is a UK taxpayer. Employee contributions are 5% of earnings, which is equal to £1,800 per annum for this individual.

## Reward and Retirement Provision

If the individual was not in the pension scheme then he would pay the following as Income Tax every year:

$$\begin{aligned} \text{Income tax without pension} &= (£36,000 - £12,570) \times 20\% \\ &= £4,686 \text{ per annum} \end{aligned}$$

With the individual in the pension scheme, the employee contributions receive Income Tax relief, and so Income Tax would fall to:

$$\begin{aligned} \text{Income tax with pension} &= (£36,000 - £1,800 - £12,570) \times 20\% \\ &= £4,326 \text{ per annum} \end{aligned}$$

Hence there is an Income Tax saving of £360 per annum, which is equal to 20% of the employee contribution (for an individual who is marginally taxed at the basic rate). The individual therefore only pays £1,440 per annum for an employee contribution of £1,800.

Under a salary sacrifice arrangement, the individual earns £34,200 per annum, rather than £36,000 per annum. Hence the second calculation above can still be used to calculate the Income Tax due, i.e., there is no change in the Income Tax treatment.

### Class 1 NICs thresholds

*Figures to use 2023/24*

*Class 1 National Insurance thresholds*

You can only make National Insurance deductions on earnings above the Lower Earnings Limit (LEL).

Lower earnings limit	£123 per week £533 per month £6,396 per year
Primary threshold	£242 per week £1,048 per month £12,570 per year
Secondary threshold	175 per week £758 per month £9,100 per year
Upper secondary threshold (under 21)	£967 per week £4,189 per month £50,270 per year
Apprentice upper secondary threshold (apprentice under 25)	£967 per week £4,189 per month £50,270 per year
Upper earnings limit	£967 per week £4,189 per month £50,270 per year

## Reward and Retirement Provision

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Taking the same individual as with the previous Income Tax example, whether the individual was in the pension scheme (without salary sacrifice) or not, the following NICs would be payable every year:

Employee NICs without sacrifice =  $(£36,000 - £12,570) \times 12\%$   
= 2,811.60 per annum

Employer NICs without sacrifice =  $(£36,000 - £9,100) \times 13.8\%$   
= £3,712.20 per annum.

Under a salary sacrifice arrangement, the individual earns £34,200 per annum, rather than £36,000 per annum. Hence the calculations above can no longer be used to calculate the NICs due. The revised NICs are as follows

Employee NICs with sacrifice =  $(£34,200 - £12,570) \times 12\%$   
= £2,595.60 per annum

Employer NICs with sacrifice =  $(£34,200 - £9,100) \times 13.8\%$   
= £3,463.80 per annum

Hence there is an employee NIC saving of £216 per annum and an employer NIC saving of £248.40 per annum. These savings are not realised unless there is a salary sacrifice arrangement in operation.

An employer can save up to 13.8% of the total salary that is sacrificed. For a scheme with an employee contribution rate of 5%, this is equivalent to almost 0.8% of contribution salary.

### Exercise

Look at your last payslip:

- If your employer does not operate a salary sacrifice arrangement, work out how much National Insurance you could save if you paid your pension contributions by salary sacrifice.
- If your employer does operate a salary sacrifice arrangement, work out how much National Insurance you are saving by paying your pension contributions through salary sacrifice.

## 3.7 CHANGES TO THE STATE SECOND PENSION

### *Before 6 April 2016*

The State Second Pension (S2P) accrued on an annual basis and was dependent on the level of earnings between the Lower Earnings Limit (LEL) and the Upper Accrual Point (UAP) in each tax year).

How much a person got depended on:

- how many years of National Insurance contributions they have
- their earnings
- whether they contracted-out of the scheme

In recent years, S2P has become increasingly flat-rate.

From April 2014, you got a standard flat-rate amount of State Second Pension, worth around £1.77 a week, for each qualifying year. Also, people earning above the Low Earnings Threshold were entitled to an extra earnings-related payment.

Moreover, S2P has been replaced by a new single-tier pension from the 2016/17 tax year but only for those reaching State pension age after 5 April 2016. This means all women born on or after 6 April 1953 will reach State Pension age after the introduction of single-tier and will receive a single-tier pension, as will every man born on or after 6 April 1951. As long as they meet the minimum qualifying period, these people will be able to get a single-tier pension.

To qualify for a full single-tier pension, 35 qualifying years will be required (i.e., tax years during working life in which a person has paid, been treated as having paid or been credited with enough national insurance contributions on their earnings for it to count as a qualifying year). A full basic State pension was available before 6 April 2016 after only 30 qualifying years. In addition, to qualify for any single-tier pension, a person must have a minimum of 10 qualifying years. However, the minimum qualifying period can be met through qualifying years before and after 2016.

The single-tier pension will be a simple, flat rate amount and will be set, in regulations, above the level of the Pension Credit Standard Minimum Guarantee. For 2023/24 the single-tier pension is £203.85 per Week or £10,600 pa. It replaces the Basic State Pension, Additional State Pension, Graduated Retirement Benefit, and the Savings Credit element of the Pension Credit.

The Pensions Act 2014 provides for the uprating arrangements for the single-tier pension to reflect those for the current Basic State Pension. So, it must increase by a percentage not less than the percentage annual increase in the general level of earnings.

A government factsheet on the single tier pension can be downloaded at – <https://www.gov.uk/new-state-pension>.

### 3.8 EFFECT ON STATE BENEFITS AND POTENTIAL LOSERS

When an individual participates on a pension salary sacrifice arrangement, they agree to a reduction in the salary they receive from their employer. As noted earlier in Chapter 3.5, the Rules of the pension scheme will usually be amended to ensure that the individual's scheme benefits are based on the same pensionable salary as before the salary sacrifice arrangement. This ensures that the member does not see a reduction in the benefits accrued.

However, the same cannot be said about certain State benefits, where the level of the benefit is determined in relation to the individual's earnings or the level of NICs that an individual pays.

The main benefit that fell into this category was S2P (as discussed in Chapter 3.7), which accrued on an annual basis, dependent on the level of earnings (between the Lower Earnings Level and the Upper Accrual Point) in each tax year. However, this issue falls away under the single-tier State pension.

There are also other consequences of a reduction in salary due to salary sacrifice. For example, the National Minimum Wage and, from April 2016, National Living Wage needs to still be met. For the purposes of this, it is the salary after sacrifice that is important. This can be an issue for low paid workers (including workers earning at or just above the National Minimum Wage / National Living Wage), part timers, and for members who are able to sacrifice a large portion of their salary through high DC or AVC contributions.

There is also a potential impact on numerous other State benefits, such as:

- Incapacity Benefits and Job Seekers Allowance
- Statutory Sick/Maternity Pay, and other "statutory" pay
- Working/Children's Tax Credits.



For a number of these benefits, it is important that the salary after sacrifice does not fall below the LEL. For the Tax Credits, salary sacrifice could actually increase the benefit payable.

### 3.9 COMMUNICATION TO EMPLOYEES

In order to maximise the take up of salary sacrifice, communication is key:

- Employees need to see that the cost of scheme membership is reduced, however supporting communications should also make employees aware of the circumstances in which they could be adversely impacted under salary sacrifice;
- The staff that the employer is trying to attract and retain need to be able to see how salary sacrifice will improve their position (e.g., through lower costs of membership, higher benefits, or the likelihood of a full flexible benefits scheme in the future);
- Employees will be more interested in the scheme if they can see that their net pay will actually increase by taking part in salary sacrifice.

The employer should therefore be prepared to spend a reasonable amount of money promoting the scheme and explaining how it works. Examples of effective methods might include:

- personalised letters to employees setting out and changes to their individual benefits, along with an estimated cost of being in the pension scheme (allowing for Income Tax relief and NIC savings)
- road shows to answer employees' questions directly
- interactive modelling tools for scheme employees to calculate their savings
- example payslips showing the estimated take home pay both before and after the salary sacrifice arrangement. See Appendix B.

### 3.10 AUTOMATIC ENROLMENT

Where an employer is operating a pension scheme and enrolling workers using salary sacrifice, it is doing so outside the automatic enrolment provisions. This does not, however, mean that the two processes cannot be run in parallel when complying with the employer's duties.

According to the detailed guidance issued by the Pensions Regulator, an employer may ask an eligible jobholder who must be automatically enrolled whether he or she wants to put in place a salary sacrifice arrangement, but scheme membership cannot be dependent on whether the jobholder agrees to the arrangement. If the eligible jobholder declines to set up salary sacrifice, the employer must automatically enroll the individual in line with the automatic enrolment provisions by an alternative method of contribution deduction.

Salary sacrifice arrangements may be put in place before or after the jobholder's automatic enrolment date. If they set it up before the automatic enrolment date, the employer may choose to use postponement to give it time to put the arrangement in place. If they set it up after the automatic enrolment date, the employer will have to use a different method of payment for the initial pension contributions due from the automatic enrolment date.

The Pensions Regulator also advises that an employer should take care when communicating the option of salary sacrifice to a jobholder. It should separate this information from the automatic enrolment information. The employer may send salary sacrifice and enrolment information together if it wishes, but where this is the case, it must avoid giving the impression that the jobholder will only be enrolled if he or she agrees to salary sacrifice.

If the employer is using a DC scheme for automatic enrolment, then the qualifying earnings used to meet the minimum requirement are the post-sacrifice level of salary.

### Summary

A salary sacrifice arrangement is one where employees agree to reduce their contractual entitlement to part of their cash pay, in exchange for an alternative employer provided benefit, such as contributions to a registered pension scheme or childcare vouchers. For salary sacrifice to be effective, the contractual right to cash pay must be reduced.

The benefits offered through a salary sacrifice arrangement are usually exempt from tax and/or NICs, and therefore there can be tax/NIC savings from obtaining these benefits through sacrifice. In the case of salary sacrifice for pension contributions there is an NIC saving for both the employee and employer. Take up of the salary sacrifice is key for the employer to maximise its NIC savings, so effective communication to members is crucial. Showing example payslips or giving employees a letter explaining how much they could save can both help to enhance take up. Automatic enrolment into the salary sacrifice arrangement, with the requirement to opt out if an employee does not want to take part, will likely ensure a much higher success rate.

Where salary sacrifice is introduced for employee pension contributions, careful consideration should be given to the benefit design. In particular, the pension scheme Trust Deed and Rules will usually need to be amended to ensure that benefits are still based on the original salary figure rather than the reduced figure. It is also important to ensure that any salary sacrifice arrangement does not breach the employer's duties under the new automatic enrolment requirements.

Due to employees earning a lower salary, salary sacrifice can affect the entitlement to benefits including the Basic State Pension, S2P, Incapacity Benefits and Job Seekers Allowance, Statutory Sick/Maternity Pay and Child/Working Tax Credits. For this reason, it is usually recommended that no employee is allowed to reduce their salary below the LEL.

Employees can currently make an NI saving of up to 12.0% of the amount sacrificed, and employers can save up to 13.8%, which for a scheme with member contributions of 5% can lead to a significant saving to the employer in the order of 0.7% of total salary.

### Self Test Questions

- What are the main reasons for an employer to introduce a pension's salary sacrifice scheme?
- Explain which categories of members the employer should pay careful attention to when considering the scheme design.
- An employer has a salary sacrifice arrangement in place, but take up has not been good. The employer is planning to re launch the salary sacrifice arrangement and has hired you to assist with this. Describe how you would increase the take up rate of the salary sacrifice arrangement?
- Outline the changes to state pensions under the Pensions Act 2014.
- Summarise the changes to salary sacrifice from 6 April 2017.

# CHAPTER 4

## Other Benefits

### INTRODUCTION

Earlier Chapters have covered a range of benefits that employers can provide to their employees by way of flexible benefit arrangements or through salary sacrifice schemes.

Companies with fixed benefit programmes will typically offer a range of non-pension benefits to employees. These will usually fall into three different categories:

- benefits required by law
- benefits included in an employee's contract
- non contractual benefits.

Each of these will be considered in turn below.

### 4.1 BENEFITS REQUIRED BY LAW

There are some benefits that an employer has to provide to fulfil their obligations under law. Two examples of these are covered below.

#### 4.1.1 Holidays

The European Union's Working Time Directive requires employers to give employees a minimum level of holiday each year. For full-time employees the requirement is for four weeks annual leave to be given in addition to statutory holidays (bank holidays). Employers are free to offer holidays in excess of this amount. Many employers see offering five- or six-weeks holiday as a way to enrich their benefits arrangements. A common practice is to offer a starting level of holiday at, say, 25 days and allow additional holiday to be awarded on a service-related basis to a maximum, possibly 30 days.

The UK has now left the EU but the above requirements remain part of UK health and safety law.

In addition to their annual holiday entitlement, employers may also allow employees to take sabbaticals and career breaks.

#### *Sabbaticals*

Sabbaticals are extended breaks from employment that are additional to holiday entitlement and may be paid. Companies will often now use sabbaticals as a means to reward length of service and to help employees achieve a better "work/life balance".

Each company will have different restrictions which apply. Employees may have to meet certain minimum qualifications (e.g., only available to permanent employees after a minimum period of service and a certain period after a previous sabbatical). The length of the sabbatical may be restricted. The sabbatical may also have to be used for certain activities (e.g., voluntary work or academic research).

#### *Career Breaks*

Career breaks are extended breaks from employment and are usually unpaid. The majority of companies will guarantee a suitable job on return to work.

Reasons for introducing a career break include:

- attracting high calibre employees by showing a commitment to their long-term career
- retaining staff with experience and skills
- reducing the number of employees who leave
- a commitment to provide equal opportunities
- to help women combine a career and family responsibilities
- in some cases, to provide a pool of skilled labour to be called upon for holiday or sickness cover, or to cover peak workloads.

As with sabbaticals, various conditions may apply to career breaks. Again, there may be eligibility criteria (e.g., permanent employees who provide an accepted reason for the break). The length of the break may be restricted (e.g., a fixed period or allow flexible working). An employer may also require some contact (e.g., for training courses) during the break.

On returning to work from full time career breaks, there is no contractual right to be employed in the same job on the same salary. However, most companies try to ensure that employees can, where possible, resume work in the same or a similar job with equivalent grade or status. For part-time career breaks, employees will be offered a salary commensurate with the new status and hours worked.

### **4.1.2 Optical care**

Under the Health and Safety Display Screen Regulations 2002 employers are obliged to provide employees using VDUs, who request one, an eye examination, funded by the employer, when requested. If glasses are needed specifically for VDU use, the employer is obliged to pay.

Many employers deliver this benefit obligation to provide eye tests by way of voucher schemes with some of the main optician chains. Where, following an examination, the optician is of the opinion that the employee requires glasses solely for VDU work the employer will be required to meet the cost of a basic pair of glasses.

### **4.1.3 Contractual Benefits**

There are a wide range of non-pension benefits that an employer can embed in an employee's contract of employment as a right. Private Medical Insurance (PMI) and Disability Insurance are two such benefits which are covered in Part 2 Chapter 2.

## **4.2 NON-CONTRACTUAL BENEFITS**

These are a range of benefits that, although not a contractual right, are benefits that are commonly provided by an employer at a cost to employees.

These can be two main kinds of benefit, those provided as a salary sacrifice option and those through a voluntary benefit scheme.

### **4.2.1 Salary Sacrifice Schemes**

#### *Childcare Provision*

To help meet the needs of parents of young children in their workforce many employers make some form of childcare provision available.

Providing on-site nurseries and playgroups is an option only practically available to the larger employer.

There are, however, other ways an employer can help with childcare costs, such as childcare vouchers. Income Tax and National Insurance must be paid on some kinds of support. Childcare schemes you don't pay tax and National Insurance on Tax and National Insurance does not need to be paid on:

- childcare vouchers
- childcare your employer arranges with a provider (sometimes known as 'directly contracted childcare')
- workplace nurseries.

An individual can get up to £55 a week or £243 per month from childcare vouchers, depending on how much they earn and when they joined the scheme.

Childcare vouchers may affect the amount of tax credits a person can get. Childcare schemes you pay tax and National Insurance on

Tax and National Insurance on must be paid on:

- cash your employer gives you to pay for childcare
- childcare provider's fees your employer pays
- school fees your employer pays.

### *Dental Cover*

Dental cover has become increasingly popular in some parts of the country as individuals find it difficult to locate dentists which operate on the National Health Service (NHS). There are two types of dental cover provided – capitation plans and dental insurance.

- Capitation plans are offered by both private and NHS dentists and are designed to meet the cost of all dental care. The individual is assessed on the state of their oral hygiene, and this then determines the monthly cost of the cover. These types of plans are typically set up on an individual basis.
- Dental insurance covers both NHS and private dentistry. The level of cover can be on a number of bases, i.e., to cover NHS costs or different levels of private dentist costs. Cover can be extended to include the employee and their family. Dental insurance is typically offered as part of a voluntary benefits plan or within a flexible benefits plan. Some organisations, however, do offer the basic level of NHS cover to their employees. This may be as a substitute for an onsite company dentist.

### **4.2.2 Voluntary Benefits Schemes**

Employers will often offer access to a range of discounted goods, services, insurances, or vouchers which an employee can choose to buy for themselves. These will be paid for from net salary. It is becoming more common for there not to be any payroll involvement at all with payment being by card direct with the scheme or item supplier.

These schemes can either be informally constituted with a number of individually negotiated discounts being offered by the company directly to its employees or can be established by a specialist third party providing an all-encompassing range of discounts accessed through a sophisticated web system.

Although the employer may meet the cost of setting up and promoting the scheme to its employees there is no other cost to the employer by way of funding the actual benefits. As these are paid for from after-tax salary there is no need for them to be reported as benefits in kind for tax purposes.

### *Retail vouchers*

Retail vouchers have decreased in popularity as a result of their attracting National Insurance contributions. In the past, they were used as a means of paying people (rather than cash, since no National Insurance contributions were payable). Now that this loophole has been closed, retail vouchers are typically used as part of a recognition plan or as part of a flexible benefits plan.

Essentially, the employer buys the vouchers in bulk at the beginning of a year. Most of the high street providers offer vouchers. In doing so, the company would benefit from discounts available, of anywhere between 3% and 10% (depending on the number of vouchers bought). In addition to retail vouchers, some companies will include leisure vouchers or cinema vouchers as a form of recognition or as part of a flexible benefits plan.

Retail Vouchers are subject to tax as a benefit in kind and NICs.

### **Summary**

There are a wide range of non pension benefits that can be provided by employers.

These fall into three categories

- benefits required by law
- benefits included in an employees contract
- non contractual benefits.

Benefits in the first two categories are usually paid for by the employer. Benefits from the last category are paid for by the employee either by way of salary sacrifice (but see the comments at the beginning of Chapter 3), net pay deduction or payment directly to the provider.

### **Self Test Questions**

- What are the three distinct groups of additional benefits?
- What benefits must an employer provide by law?
- Describe the tax situation for employees opting for childcare vouchers.
- Provide an example of the possible criteria that may apply to employees wishing to take a sabbatical.

# APPENDIX A

## Comparison of SAYE Plan and SIP

	SAYE Plan	SIP
Purpose	To allow employees to purchase shares in the company at a discount in future with no risk before the acquisition date.	To allow employees to purchase shares in the company immediately, and (optionally) to allow them to be given free shares without a tax charge.
Benefits of purchasing shares this way	Company can grant up to a 20% discount on the price, but payment is out of taxed income.	No discount, but shares are purchased out of pre-tax income (no tax clawback provided shares are held for five years).
Purchase amount	Maximum £500 pm. Tax free interest on accumulated savings.	Maximum £150 pm (but not necessary to pay monthly – could be, e.g., out of annual bonus).
Flexibility to change employee contribution	At start of contract only.	At any time.
Value of shares that can be gifted	No such feature.	Up to £3,600 p.a. free shares distributed across the board (plus up to £3,600 by way of 2:1 matching shares). There is also a “share dividend” reinvestment element that can be offered which is also tax free
Purchase price	Guaranteed at start of contract.	Variable from time to time.
Provision of shares	Share option – shares usually issued when option is exercised.	Share gift usually paid out of profits by subscription of new shares or market purchase.
Holding or deferral period	Exercise after 3 or 5 years	At least 3 years and up to 5 years holding requirement (enforced by a trust). In practice, most plans have a 3 year limit but tax relief is lost if the shares are sold within 5 years.
Forfeiture	Savings and shares cannot be taken away.	Free shares can be made subject to forfeiture if the employee leaves within 3 years, but this would not make much sense if the free shares are seen as an earned profit share payment.
Taxation	If option exercised, gain free of income tax and NIC – subsequent sale liable to CGT on post exercise growth if not within exemptions.	Free and matching shares are tax and NI free gifts if retained for 5 years. Subsequent sale liable to CGT on entire value if not within exemptions.

<https://www.gov.uk/tax-employee-share-schemes>

NB If a business offers UK employee share plans, they need to do the following by 6 July 2023 for the 2022/23 tax year - complete end of year reporting for share plans and arrangements, register all new share plans and arrangements on the HMRC online system, self-certify new tax-favoured share plans. If they do not, then penalties apply and they will lose the tax-favoured treatment for certain share options.

# APPENDIX B

## Salary Sacrifice

### Example Payslip

The following payslips show how salary sacrifice would affect the monthly payslip for the individual from the examples in Part 3 Chapter 3.6.

From the payslips you can see that the take home pay has increased by £15 (for a month) which translates into an annual saving of £180 per annum.

### Before Payslip

Pay Details			
Pay		Deductions	
Item	Value	Item	Value
Salary	2,500.00	Tax Paid	£265.50
		Employee NIC	£174.30
		Employee Pension	£125.00
Total pay this period		Total deductions this period	Take home pay this period
£2,500.00		£564.80	£1,935.20

### After Payslip

Pay Details			
Pay		Deductions	
Item	Value	Item	Value
Salary	£2,500.00	Tax Paid	£265.50
Salary Sacrifice Reduction	(£125.00)	Employee NIC	£159.30
Total pay this period		Total deductions this period	Take home pay this period
£2,375.00		£424.80	£1,950.20





