101 Employer And Employee Tax Tips

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About This Guide

The opportunities for employees to legitimately reduce the tax that they pay are more limited than for the self-employed and those operating through a family company. However, the tax legislation includes a surprisingly large number of exemptions and reliefs, which make it possible for employers to implement tax-efficient remuneration strategies and to provide elements of the remuneration package free of tax.

This guide contains 101 tax tips for employees and employers. It highlights various exemptions and reliefs available to employees, methods for saving work and strategies for tax-efficient remuneration.

However, it should be noted that tips in this guide are for illustration purposes only and are intended to demonstrate where tax savings can be made. The savings that can be made will depend on the precise circumstances and the examples are a guide only.

Professional advice should always be sought.

Chapter 1.
Tax-Efficient Remuneration

1. Designing A Tax-Efficient Remuneration Package
2. Salary Sacrifice Arrangements Can Still Be Beneficial
3. Beware The Alternative Valuation Rules For OpRAs
4. Choose Non-Cash Benefits To Save Employee NICs
5. Salary Plus Benefit Rather Than Salary Sacrifice

1. Designing A Tax-Efficient Remuneration Package

A typical remuneration package comprises a number of elements. Some of these are subject to legislative control.

For example, employers must pay employees in accordance with the National Minimum Wage legislation, paying at least the National Living Wage to workers aged 21 and older and, for workers under the age of 21, at least the National Minimum Wage for their age. In addition, employers must comply with the equal pay legislation and provide paid holiday at least equal to the statutory minimum. However, other aspects of the remuneration package are at the discretion of the employer.

In setting the remuneration package, the employer must have regard to a range of factors, including the culture of the organisation, market conditions and industry norms. Within these parameters, there are opportunities to structure the package to take advantage of the various tax and National Insurance exemptions and reliefs available. These can generate tax and National Insurance savings for the employee and National Insurance savings for the employer.

The opportunity to save tax and National Insurance should be taken into account when designing a remuneration package. However, as always, this is only one element and all factors affecting the pay and performance culture of the organisation should be considered.

2. Salary Sacrifice Arrangements Can Still Be Beneficial

The opportunities to use salary sacrifice arrangements to save tax and National Insurance were seriously curtailed with the introduction of the alternative valuation rules that apply from 6 April 2017 to value benefits provided under an optional remuneration arrangement (OpRA). The pitfalls associated with these rules are discussed in Tip 3.

Where the rules apply, the benefit of any associated tax exemption is lost if a benefit is provided through a salary sacrifice or other OpRA. Under a salary sacrifice arrangement, an employee gives up an amount of salary in return for a benefit in kind. Where the benefit is one of the few that remains exempt from tax when provided under a salary sacrifice arrangement, the employee saves tax and the employer and employee save National Insurance.

The alternative valuation rules do not apply to the following benefits, and thus the associated tax exemption remains available where provision is made via a salary sacrifice arrangement:

- employer-provided pension savings;
- employer-provided pension advice;
- childcare vouchers;
- employer-supported childcare;
- workplace nurseries;
- employer-provided cycles and cyclists' safety equipment (including 'cycle to work' schemes).

Providing any benefit from the above list under a salary sacrifice arrangement will enable the employee to save the tax that would have been payable on the cash salary, and the employee and the employer to save the Class 1 National Insurance that would have been paid had the employee continued to receive the ‘sacrificed’ salary.

However, it should be noted that an employee can only benefit from the limited exemptions for employer-supported childcare and childcare vouchers if they were a member of their employer’s scheme on 4 October 2018. Employees should also check that they would not be better off using the Government’s tax-free top-up childcare scheme – it is not possible to benefit from both the Government scheme and the tax exemption.

In addition to the benefits listed above, the alternative valuation rules do not apply to low emission cars with CO_2 emissions of 75g/km or less. Where such cars are provided under a salary sacrifice arrangement or if a cash alternative is offered, the provision of the low emission car is taxed by reference to the company car tax rules, rather than by reference to the alternative valuation rules (see Tip 3).

A salary sacrifice scheme allows the employer to offer employees the opportunity to benefit from the tax exemptions available for the benefits listed above, without passing the cost of providing those benefits to the employee.

A salary sacrifice arrangement can also generate National Insurance savings for the employee where the benefit provided is either not exempt from tax or the exemption is lost as a result of the alternative valuation rules coming into play. The employee’s National Insurance saving results from replacing cash salary (which is liable to employee and employer Class 1 contributions) with a non-cash benefit which is liable to employer-only Class 1A contributions. However, when taking into account the administrative costs of administering the salary sacrifice arrangement, this may only be worthwhile if the National Insurance savings are significant.

For a salary sacrifice arrangement to be regarded as effective by HMRC, the employee must not be able to revert to the higher salary at will.

Salary Sacrifice Arrangements Can Still Be Beneficial

Helen’s employer operates a salary sacrifice scheme to enable employees to swap cash salary for non-cash benefits.

Helen gives up £5,000 of salary a year in return for an employer contribution to her pension scheme.

The alternative valuation rules do not apply and Helen is able to save tax and National Insurance on the salary given up, while enjoying a tax-free benefit. Her employer also saves employer’s Class 1 National Insurance contributions on the foregone salary.

3. Beware The Alternative Valuation Rules For OpRAs

The benefits of using a salary sacrifice or other optional remuneration arrangement (OpRA) were seriously curtailed from 6 April 2017 following the introduction of alternative valuation rules that apply where a benefit or expense is provided via an OpRA. The definition of an OpRA includes not only salary sacrifice schemes, but also flexible benefit arrangements and arrangements, such as cash or a car, where the employee is offered the choice between a non-cash benefit and a cash alternative. The alternative valuation rules do not apply to certain benefits, and these can continue to be provided to employees under OpRAs without a loss of the associated exemption. Tip 2 explains how salary sacrifice arrangements can continue to be beneficial for benefits that fall outside the alternative valuation rules.

The alternative valuation rules apply to all benefits provided under an OpRA other than:

- employer-provided pension savings;
- employer-provided pension advice;
- childcare vouchers;
- employer-supported childcare;
- workplace nurseries;
- employer-provided cycles and cyclists' safety equipment (including 'cycle to work' schemes); and
- low emission cars with CO_2 emissions of 75g/km or less.

Where they apply, the value of the benefit for tax purposes (i.e., the amount on which tax and National Insurance are payable) is the higher of:

- the amount of salary given up in return for the benefit or the cash alternative offered; and

- the cash equivalent value calculated under the normal rules.

Any amount made good by the employee is deducted (as long as the amount is made good by 6 July following the end of the tax year).

Where a benefit would otherwise be exempt, the cash equivalent value would be nil. However, where provision is made via an OpRA, under the alternative valuation rules the employee is taxed on the salary foregone as this will be higher than a cash equivalent value of nil, with the effect that the exemption is lost.

Beware The Alternative Valuation Rules For OpRAs

Tim's employer has for many years operated a salary sacrifice arrangement under which he gave up £1,000 of salary in return for which his employer provided a parking space in a car park near the office.

The provision of a parking space when provided other than via an OpRA is an exempt benefit.

However, the alternative valuation rules apply where provision is made under an OpRA, such as a salary sacrifice arrangement. Consequently, Tim is now taxed on the higher of:

- the salary foregone (£1,000); and
- the cash equivalent under normal rules (nil).

Despite swapping £1,000 of his salary for an employer-provided parking space, Tim is taxed as if he had continued to receive the salary. The alternative valuation rules render the arrangement ineffective from a tax perspective. Had he simply received the benefit of the parking space in addition to his salary, the associated tax exemption would apply and he would be able to enjoy the benefit of the parking space tax-free.

Although the tax savings are lost by using a salary sacrifice scheme to provide the benefit, the employee National Insurance savings remain as the liability is to Class 1A rather than to Class 1. This is worth either £80 or £20 a year depending on whether Tim's earnings exceed the upper earnings limit (£50,270 for 2024/25). The employer National Insurance savings are, however, lost as the employer will pay Class 1A National Insurance at 13.8% – the same rate as employer Class 1 National Insurance contributions on the employee's cash salary.

4. Choose Non-Cash Benefits To Save Employee NICs

Even if a benefit is not exempt from tax and National Insurance, it can still be beneficial from the employee's perspective to choose the benefit rather than cash salary, as this will save the employee Class 1 National Insurance contributions.

Most taxable benefits provided to employees are liable to Class 1A National Insurance contributions rather than to Class 1. Class 1A National Insurance is only payable by the employer – there are no employee Class 1A contributions.

By swapping cash salary for a non-cash benefit, the National Insurance liability switches from Class 1 (payable by both employees and employers) to Class 1A (employer only), saving employee National Insurance contributions.

However, the extent to which this is worthwhile will depend on the amount of National Insurance payable and may not be significant where the employee's earnings are above the upper earnings limit (£50,270 for 2024/25). The reduction in the primary rate to 8% for 2024/25 reduces the savings that can be achieved where the employee's earnings are between the primary threshold (£12,570 for 2024/25) and the upper earnings limit. Care should be taken that any administration costs do not exceed the National Insurance saved.

As noted in Tips 2 and 3, alternative valuation rules apply where benefits are provided under optional remuneration arrangements, such as salary sacrifice schemes. However, despite these rules, such arrangements can continue to generate National Insurance savings by moving the liability from Class 1 to Class 1A.

Choose Non-Cash Benefits To Save Employee NICs

George receives a cash salary of £30,000 a year and private medical insurance of £600 a year. He pays no National Insurance on the private medical insurance. As a result, he is £48 per year (£600 @ 8%) better off than if he had received an additional £600 in salary and paid for the medical insurance from his net pay.

The employer pays Class 1A National Insurance of £82.80 (£600 @ 13.8%) on the benefit – which is the same as the employer Class 1 contributions payable on salary of £600. Although the employer is not better off, they enjoy a cash flow advantage as Class 1A contributions are paid after the end of the tax year whereas Class 1 contributions are payable during the year. However, the employer is unable to set the employment allowance against Class 1A contributions.

If, however, George had been earning, say, £60,000, the saving would only be £12 (£600 @ 2%) and is unlikely to be worthwhile.