The Phantom of the OpRAs

Employment Tax

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Michael Steed looks at the new income tax and NIC rules for OpRAs and asks who the winners and losers are

Key Points

What’s the issue?

Salary sacrifice and the taxation of flexible benefits packages changed in April 2017 and employers and employees alike will need to understand the scope of the changes.

What’s changed?

Salary sacrifice has been subsumed into a new regime called Optional Remuneration Arrangements (OpRAs), where IT and NIC savings are greatly reduced (including down to zero) in many cases.

What can I take away?

Employers will need to make sure that these new rules are effectively communicated to employees, so that both sides can make informed judgements about whether such remuneration schemes still make sense.

What has changed and why?

Salary sacrifice schemes have been popular for years with both employers and employees. At its simplest, an employee sacrifices salary and receives in return benefits of equal value. The difference, at best, is that by receiving benefits instead of salary, both employer and employee will save tax and/or NICs.

The rules have been changed because HMRC has become increasingly concerned that salary sacrifice schemes have been over-used and in circumstances where it was never intended that they should be used, for example paying employee travel expenses. The Government was never going to let this continue with its attendant loss of tax and NIC revenue.

The upshot of this is that salary sacrifice has been subsumed into a new Optional Remuneration Arrangements regime (OpRAs) and the IT and NIC outcomes are generally worse than they were before April 2017.

What are OpRAs?

The new legislation is in Schedule 2, FA 2017 and inserts new provisions into ITEPA 2003 (starting at new section 69A).

OpRAs are schemes where the employee is provided with a benefit in return for giving up some form of salary, cash pay or allowance and will be caught under the new rules if provided under arrangements where the employee:

- Gives up the right, or the future right, to receive salary (commonly called salary sacrifice) (Type A arrangements) (new ITEPA 2003 s 69A(3)); or
- Agrees to be provided with the benefit rather than an amount of cash pay (Type B arrangements) (new ITEPA 2003 s 69A(4)) .

Simply put therefore, in Type A arrangements, an employee gives up something and in Type B arrangements, they choose something. The rules for OpRAs will therefore impact on flexible benefit packages.

Where a benefit is provided under optional remuneration arrangements, the value of the benefit to be treated as earnings from the employment, is the greater of:

- the amount of salary or cash pay given up by the employee in return for the benefit;
- the amount of the benefit treated as earnings from the employment under the normal rules, ignoring any amount made good.

Where the two are the same, then the normal benefit valuation rules are used.

Examples:

An employee gives up £1,000 of salary for benefits that are valued at £900. The higher value of £1,000 is used.

- An employee chooses between a pay rise of £2,000 and a car (which is not a low emission vehicle) where the cash equivalent is £2,200. The higher value of £2,200 is used.
- An employee gives up cash of £1,500 for a benefit that is worth £1,500. There is no difference between the values – £1,500 is used.

Some employees have both type A and type B arrangements under which a benefit is provided partly in exchange for the employee giving up an amount of salary and partly in exchange for giving up the option of a cash allowance. Where this is the case, the amount foregone is the total value of the type A and type B arrangements.

HMRC example:

An employee has the option of a cash allowance of £5,000 (type B) which he decides to give up for a car. However, the employee wants a higher specified model costing a further £1,000. So, he also gives up £1,000 of salary (type A). The amount foregone is £5,000 plus £1,000.

Are all benefits affected by this new regime?

No, if a benefit is provided by an employer and there is no salary sacrifice or agreement to choose a benefit rather than cash, then the new rules do not kick in. The existing rules apply.

So, if an employer provides an annual medical check-up under the provisions of S320B, ITEPA, no tax or class 1A NIC liability arises (where no IT charge arises, it follows that no Class 1A NIC liability arises – S10, SSCBA 1992). This may suit, for example, the directors of a family company. If that same company provides this benefit to their employees, then these, too, will be tax and NIC free.

But if the medical check-up is provided under an OpRA, say to an employee under salary sacrifice, then the new rules will apply and the benefit will be valued at the higher of the cash equivalent (valued at £0 under the BIK rules) or the salary forgone (agreed between the employer and employee). It will also be subject to Class 1A NICs on this higher figure.

When making the comparison, you ignore any amounts made good. However, once you have determined the relevant amount, in most cases the taxable amount is reduced by any amount made good by 6 July following the end of the tax year in which the benefit was provided.

Example (from HMRC's revised Booklet 480 – 2017 edition)

An employer provides an employee with private medical insurance that costs it £500. The employee gives up her right to salary of £600. The relevant amount treated as earnings from the employment is £600, being the greater of the cost of providing the benefit (£500) and the amount foregone (£600). If the employee then makes good £50, this reduces the relevant amount by £50 to leave an amount treated as earnings from the employment of £550.

Some benefits are not affected (at least for now). The new rules identify some 'Excluded exemptions' (in new ITEPA 2003 s 228A(5)) and these include:

- payments by employers into registered pension schemes;
- childcare vouchers, workplace nurseries, and directly contracted employer provided childcare;
- cycles and cyclists' safety equipment (including Cycle to Work);
- ultra-Low Emission Cars (ULEVs) with CO2 emissions of no more than 75g per kilometre that are in the scope of the car benefit charge.

So these benefits, with any IT and NIC advantages, are preserved as the Government wished to encourage them.

There are also some 'Special case exemptions' in ITEPA 2003 s 228A(4), which have already been removed from salary sacrifice schemes, so these too are not within the new rules (presumably to avoid any double taxation). These include: subsidised meals, reimbursed expenses and trivial benefits.

When are the new rules triggered?

After April 2017, the new rules are triggered when a salary sacrifice agreement starts or is renewed, or modified.

If the existing arrangements are in place on 6 April 2018, then that date will be the trigger point, unless the benefit is a car with emissions in excess of 75 gm per km, school fees or living accommodation benefit. These exceptions are all protected until the earlier of:

1. a variation, renewal, modification of the arrangements; and
2. 6 April 2021.

There are special rules for school fees.

What are the new NIC rules?

The basic shape of the new NIC rules is that benefits that are provided under OpRAs will be charged to Class 1A NICs, so the pre-2017 rule that there was an exemption from Class 1A NICs where there is no IT charge has changed (S10, SSCBA 1992).

The NIC rules mirror the IT rules, so the value is the higher of the two values chosen for IT purposes.

The 'excluded exemptions' rule for IT is also mirrored by the NIC rules.

What about cars that are made available for private use?

There's good news and bad news!

The new rules do not apply to cars with CO2 emissions of 75 grams per km or less (a ULEV).These vehicles continue to be taxed on just the cash equivalent of the benefit worked out under the normal rules without having to make a comparison with the salary foregone. They are subject to Class 1A NICs in the normal way.

Cars made available for private use with emissions of more than 75 grams of CO_2 per km are within the optional remuneration arrangement rules. They are also complicated by the fact that the BIK rules on valuation allow for capital contributions (say for higher specification cars) and payments for private use.

The basic ‘higher of’ rule is still in play, but the cash equivalent is now modified to exclude any payments from the employee, but credit is given for these payments as shown in the following example:

Example (from HMRC’s revised 2017 Booklet 480)

An employee is provided with a car in the 2017/ 2018 tax year in return for giving up £300 salary per month or £3,600 per year. The car has a list price of £20,000 and an appropriate percentage of 17%. The employee also makes a capital contribution of £1,500 for a higher specification vehicle. The cash equivalent value of the vehicle would normally be £3,145 ((£20,000 less capital contribution £1,500 =£18,500) x 17%). The modified cash equivalent is, however, £3,400 (£20,000 x 17%) as no account is taken of the capital contribution.

The modified cash equivalent is then compared with the amount foregone of £3,600. The amount foregone of £3,600 is greater, so this amount is used in determining the relevant amount. The relevant amount to be treated as earnings is £3,600 less £255 (capital contribution of £1,500 x 17%) = £3,345.

What does all this mean?

Employers offering OpRAs will need to be clear about which benefits provide tax and NIC advantage and which will not.

Some OpRAs will still be of interest, such as pensions, cycle to work schemes and low emission cars and some will be much less tax-efficient. Clearly, if the salary foregone and the cash equivalent are the same, there will be no change for an employee.

Having said that, employees are not generally interested in the increased loading of Class 1A NICs on employers, they are only concerned with IT and their own Class 1 NIC liability and the trade-off between the value of the benefit and take-home pay.

For employers, increased costs under the IT valuation rules mean higher Class 1A costs and although these will be allowable revenue deductions under the IT and CT rules, this will still be a factor in the decision to offer OpRAs or not.

HMRC has produced guidance in the Employment Income Manual at EIM 44040 onwards.