How employer attempts to address the cost of living crisis can fail to deliver

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As the cost of living crisis encourages employers to think creatively about how to support their staff, we examine how this support can fail to deliver.

Key Points

What is the issue?

The cost of living crisis is causing some employers to look for steers on ways to support employees.

What does it mean for me?

As well as the tax implications for employees, where they are lower paid, it is key that advisers understand the universal credit interactions of some of the potential solutions.

What can I take away?

Sometimes they can mean employees may not feel much of the benefit of their employer's generosity – awareness, communication and signposting to specialist support are key.

You may remember the furore a few years ago when Greggs announced that a £300 bonus would be paid to all staff, linked into the success of the company's vegan sausage rolls. The furore wasn't because of the gesture per se. It was because it transpired that some workers who were on universal credit would keep just £75 of the £300 pay-outs because universal credit is a means-tested benefit.

The cost of living crisis has seen an explosion of suggestions as to how to employers can support employees. If you are an adviser with employer clients that are investigating some of the main options, this article will help you by looking at the reality of marginal deduction rates and the other weird and wonderful universal credit interactions that you need to be aware of.

First things first: how does universal credit work?

Universal credit is a monthly payment. Broadly, the amount of universal credit a person is entitled to is based on their personal circumstances, their capital and other income, and importantly their net pay in a monthly assessment period. Every time an employer pays someone, a copy of the Real Time Information payroll data is sent to HMRC. This Real Time Information data is shared by HMRC with the DWP for universal credit purposes.

Further detail about how UC works, aimed at employers, can be found at bit.ly/3RYANog.

Giving a pay rise or offering overtime or additional hours

Boosting incomes is perhaps the most obvious way in which employers can support employees, and will likely have the most immediate impact.

From an employee’s perspective, earning more means that things like tax and National Insurance might increase, as well as sometimes paying more in pension contributions. But it may also impact on the amount of universal credit they receive, as the higher their wages, the less universal credit they get.

For universal credit purposes, there is a 55% withdrawal rate on net pay. Some claimants are entitled to a work allowance of up to £573 per month before universal credit starts to be progressively withdrawn. See ***Impact of a pay rise on universal credit*** for a basic illustration of how this works in practice.

Impact of a pay rise on universal credit

Jenny, 35, is a lone parent. She usually works around 25 hours a week in a pub, at the minimum wage. At £9.50 per hour there is no tax or NIC (earnings of £237.50 per week). Because Jenny is on a low income, in a month where there are five pay days in the universal credit assessment period she receives universal credit of £286.93.

If Jenny’s employer were to give her a pay rise or increase her hours such that she received an extra £25 per week, based on current rates, her award would be £236.91 per universal credit assessment period. There is also tax and NIC at 33.25% on her earnings above £242 per week (£6.81 per week).

So, of her £125 increase in terms of gross earnings during her universal credit assessment period (assuming there are five pay days in that period), the true value of the £125 increase to Jenny is only £40.93. The Treasury receives the remaining amount (£84.07) in reduced welfare payments (£50.02) and increased income tax and NIC revenue (£34.05).

The marginal deduction rate on the £125 is 67%. And this is before we consider whether Jenny might lose any passported benefits.

A one-off bonus

Some employers may not be able to afford an ongoing increase in pay or hours but may prefer to top up an employee’s pay with a one-off cost of living payment. However, for some lower paid employees who are near the edge of eligibility for universal credit, a one-off bonus could mean that their income in the universal credit assessment period is high enough to leave a nil universal credit award and close down the claim, requiring another claim to cover the next assessment period. Our understanding is that there is a rapid re-claim process in such cases.

If someone receives a very large bonus or earns much more than usual in one month, this may also affect their universal credit payments in later months. This is known as surplus earnings and is outside the scope of this article; however, more information is available on LITRG's Revenue Benefits website (see bit.ly/3S2jqmk).

Changing pay frequencies

An employer's response to the cost of living crisis does not have to just be about increasing an employee's income directly. Many people these days are paid monthly, as this saves quite a lot of payroll administration for employers. However, this often does not match an employee's cash flow needs. Some employers may be considering changing their pay frequency to weekly instead of monthly and so allow employees to access their earnings more regularly.

Providing that this isn't done mid pay period, the transition should be smooth for payroll purposes. However there might be universal credit issues. If employees are paid monthly, then one month's net pay should fall into each assessment period, and as a broad rule their universal credit payments should not vary significantly from month to month if their net pay remains broadly the same. (There can be exceptions to this where the payday is close to the beginning or end of an assessment period.)

However, if employees are paid weekly, then they should be aware that some assessment periods are likely to have four weeks net pay in them and some will have five weeks net pay in them. This means that their monthly universal credit payment will change according to whether there are four or five wage payments in the assessment period.

Employees may need to take care to budget for these peaks and troughs in the payment cycle. Indeed, it may be the case that in five week periods, the extra amount means they receive no universal credit payment at all. There is further information about this on GOV.UK which can help employees to understand when they might see changes to their universal credit award as a result of their pay frequency (see bit.ly/3R0wV5f).

Salary advance

As an alternative to changing pay frequencies, some employers may be minded to offer a salary advance; for example, to help employees deal with an emergency without accruing debt.

For payroll purposes – strictly, where there is an advance of wages (essentially a payment on account of earnings, which is money the employee has earned but which is not yet due for payment) – this is reportable by the employer and taxable on the employee at the time the payment is made. There is, however, an easement for ‘ad hoc’ payments outside the normal payroll run, which may sometimes apply. Further HMRC guidance on advances and on the difference between a salary advance and a loan can be found at bit.ly/3BIifTJ.

Where an employee is advanced some money (where the easement doesn’t apply and it is not structured as a loan), this could place a reporting obligation on the employer and in turn effect the employee’s universal credit. If someone receives their employment income early, it can fall into a different assessment period, so it can look to DWP as though they have received more salary in that assessment period than they really have, causing some of the same universal credit fluctuation/cessation issues described above.

Some employers may be considering using a salary advance scheme rather than paying a salary advance themselves. In a salary advance scheme, a third party salary advance company works with an employer to let employees access part of their salary as they earn it, rather than having to wait until their payday.

In terms of how we understand the schemes operate (and given what we say above about the tax treatment of advances), it is interesting that the schemes seem to say that payment of an advance does not impact on the employer’s payroll processes. The Financial Conduct Authority has highlighted other risks of using salary advance schemes - for both employees and employers (see bit.ly/3BghlfH).

Beneficial loans and other benefits

A cheap or interest free loan could help employees to buy season tickets or help them consolidate expensive debt. For tax purposes, there may be a taxable benefit if the amount of the loan exceeds £10,000 in the tax year. This is worked out based upon an assumed interest charge at the official rate of interest less any interest the employee has paid.

Benefits in kind that are not taxable, are not treated as income for universal credit, so as well as most beneficial loans, other useful benefits that an employer could provide in the current climate that would not impact on a universal credit award are things like welfare counselling, goods provided at a discount (provided that the amount the employee pays is at least the cost incurred by their employer in making the goods) and free or subsidised meals.

It is of note that 'employed earnings' for universal credit are defined as any amounts that HMRC treat as 'general earnings' – but leaving out any amounts treated as earnings under the benefits code. This means that benefits in kind which HMRC *would* normally treat as earnings, are **not** currently treated as income for universal credit purposes. A full list of benefits in kind not yet treated as earnings can be found in Advice for Decision Making (ADM) Chapter H3 para H3081 (see bit.ly/3S7OjWo).

Although we do not cover tax credits in this article, it is worth us pointing out that this is not the same situation as for tax credits, where taxable benefits in kind are generally counted as income.

Other thoughts

Other solutions may not leave employees worse off or inconvenienced from a universal credit perspective but may still require careful thought where you have low paid employees. For example, implementing a salary sacrifice scheme to help employees with pension saving can not only save them employee NIC but the reduction in contractual pay can increase their universal credit award. However, remember that strictly those at or near the minimum wage should not participate in salary sacrifice – and some lower paid employees may lose out in other ways which will require careful consideration.

Some employers may want to pay or reimburse employee business mileage at more than the HMRC 'approved' amount. As explained in a recent publication (see bit.ly/3djadY6), this brings with it an administrative burden for employers as well as tax and National Insurance implications for employees that they may not be aware of – and yes, you guessed it – potential knock-on effects for universal credit.

None of the difficult universal credit interactions mentioned in this article are arguments for employers not to help staff. If anything, they are arguments that the tax and benefits rules for lower paid employees could probably do with being rethought! The point of the article is to raise awareness, so that the issues can be communicated and any impacts can be anticipated and even mitigated.

We appreciate that many employers won't know whether their employees receive universal credit or not. Even if they do, they're unlikely to be privy to the personal circumstances that determine how the different options could impact them. One practical suggestion for employers who *may* have employees on universal credit and who want to help them by implementing one or more of the options covered, is to signpost them to a welfare rights adviser such as Citizens Advice for advice on how their universal credit could be impacted.