

VAT on Salary Sacrifice Arrangements

In this update, we report on the forthcoming changes to the tax treatment of salary sacrifice arrangements with effect from 1 January 2012.

Over a year ago, in the case of *AstraZeneca UK Limited v HMRC*, the European Court of Justice (ECJ) held that VAT was due on the amount of salary sacrificed by employees in exchange for high street shopping vouchers. As a result of this decision, HMRC has indicated in its recently published Revenue & Customs Brief 28/11 that VAT must be accounted for on amounts of salary sacrificed by employees in exchange for relevant benefits from 1 January 2012.

VAT: How It Works

VAT is a tax charged on most supplies of goods and services. Every VAT registered business is effectively a tax collector: a VAT registered business must account to HMRC for the VAT its charges on its supplies (output VAT). However, it can generally recover the VAT that it pays on its purchases (input tax).

As a result of the decision in *AstraZeneca*, where an employer provides certain benefits to employees, this may constitute a supply of services. Where the employees pay for that benefit, output VAT may be due to HMRC on that payment. Accordingly, the overall cost of the benefit will increase, so the question for employers to decide is whether to bear the cost themselves or to pass it onto their employees.

The Decision in *AstraZeneca*

Pharmaceutical company AstraZeneca offered its employees the option of receiving part of their salary in shopping vouchers instead of cash, which were redeemable at different retailers. AstraZeneca completed its VAT returns on the basis that it was not required to charge output VAT on the provision of vouchers on the analysis that they are not given to the employees for

consideration. AstraZeneca also considered that it should be able to recover the input VAT incurred on buying the vouchers because the cost of the vouchers was a business overhead, and sought to claim reimbursement from HMRC.

However, HMRC refused to grant AstraZeneca's application. AstraZeneca appealed and the case was subsequently referred to the ECJ. The ECJ decided that the provision of vouchers as part of a salary sacrifice scheme amounted to a supply of services effected for consideration. In other words, the salary sacrificed by the employees in return for the vouchers is payment for the vouchers. Accordingly, it was held that, whilst AstraZeneca was able to recover the input VAT incurred on acquiring the vouchers, output VAT was due on the consideration received from its employees.

Summary of Revenue & Customs Brief 28/11

The Brief explains that, prior to the *AstraZeneca* decision, HMRC policy distinguished between the VAT treatment of supplies of benefits provided via a deduction from salary and those provided under a salary sacrifice arrangement. Whilst output VAT is due on a deduction from salary, it was previously accepted that output VAT was not

due where an employee gives up the right to part of their salary as part of a salary sacrifice arrangement. However, HMRC no longer considers that there is a distinction. The amount of salary foregone is consideration for supplies of benefits whether provided via a salary sacrifice or by a deduction from salary.

Accordingly, from 1 January 2012 onwards, salary sacrificed in return for a benefit will be treated for VAT purposes as constituting consideration for the provision of the benefit in question. Where the benefit concerned is liable to VAT, then subject to normal rules, input VAT is recoverable but output VAT will be due on the amount of salary sacrificed. The position in respect of income tax remains unaffected.

Affected Benefits

The principles established in the case of *AstraZeneca* in respect of shopping vouchers are equally applicable to other benefits offered to employees in exchange for consideration:

Cycle to Work Scheme

VAT will be due on monthly salary sacrificed in exchange for the hire or loan of a bicycle and associated equipment. However, an employer can continue to recover input VAT on the purchase of the bicycle and associated equipment. VAT remains due when a bicycle is disposed of at the end of the hire period.

Face Value Vouchers

VAT will be due on monthly salary sacrificed in exchange for face value vouchers, such as shopping vouchers or electronic top-up cards. However, employers are able to recover input VAT incurred on acquiring the vouchers.

Childcare Vouchers

Childcare vouchers are not directly affected because they are exempt from VAT. Further, where employers incur administration fees from their voucher provider, input VAT may not be recovered.

Meals

Where meals are provided to employees under salary sacrifice arrangements, output VAT will be due. However, if the employees do not pay for their meals, VAT is not due (provided that the benefit is available to all staff).

Company Cars

In most cases, employers are prevented from recovering input VAT in full on the purchase and leasing of company cars. This means that employers do not usually account for output VAT when cars are made available to employees. However, to the extent that an employer is able to recover input VAT, output VAT is due from salary sacrificed.

Pensions

Pension contributions are outside the scope of VAT. Accordingly, pension arrangements will not be affected by the forthcoming changes.

Benefits Provided for No Deduction or Reduction in Salary

Benefits provided to employees free of charge will not be affected. For example, VAT is not due where an employer offers a workplace gym to all employees for no deduction or reduction in salary.

Implementation of the Changes

Salary sacrifice schemes have become popular as a tax effective way of structuring employee remuneration. In view of the forthcoming date of implementation, employers should now be identifying affected benefits and considering how to deal with any additional VAT liability going forward. Some employers have even cancelled benefits due to the VAT consequences.

Where affected schemes are retained, employers must decide whether to bear the cost of the VAT themselves, which may affect the overall viability of the scheme, or whether to pass the cost onto their employees, which may affect the take-up of the scheme. If the cost is to be passed onto the employees, agreement may be required from employees who are already signed up to an ongoing salary sacrifice scheme which extends beyond 1 January 2012. Employers should be careful to review their arrangements to ensure that they comply with all their VAT, income tax and employment law obligations.

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