

UK Tax Tribunal Highlights Risks of Improperly Implemented Salary Sacrifice Schemes

In the recent case of *Reed Employment*, the First-tier Tax Tribunal found the Reed group of companies liable for £158 million of tax and national insurance following a failed salary sacrifice arrangement. The case is a salutary warning for all employers either operating or thinking about introducing salary sacrifice schemes to take great care to ensure that they are robust and consistent with HMRC's requirements.

The Reed Employment group of companies is an employment business or agency which provides temporary employees to client businesses, usually on a short term basis. Between 1998 and 2006, Reed operated a 'salary sacrifice' arrangement involving around 500,000 temporary workers which was designed to take advantage of the tax provisions allowing certain employees to claim deductions against earnings for travelling and subsistence expenses. The primary benefit of the arrangements accrued to Reed, in the form of significant NIC savings.

Broadly, the basis of the arrangement was that temporary employees would sacrifice a sum of earnings in exchange for the payment of a tax free allowance to reflect their travelling and subsistence expenses. HMRC took the view that Reed's contracts with the temporary employees did not provide for an effective salary sacrifice, and there was no such sacrifice as a matter of fact. Accordingly, the allowances did not represent a reimbursement of expenses, but were simply part of the employees' taxable earnings. Separately, HMRC argued that even if the allowances were paid in respect of expenses, those expenses were not deductible because of the nature of the temporary workers' employment status.

No Sacrifice

The key findings of the tax tribunal were as follows:

- There was no valid salary sacrifice. A successful salary sacrifice requires an element of reciprocity, which was not present in the arrangements. The scheme gave no real benefit to the employees but merely allowed Reed to attribute part of their pay, entirely notionally, to the reimbursement of expenses in order to reduce its tax burden. The 'sacrifice' was no more than an arithmetical adjustment.
- Even if there had been the required element of reciprocity, the sacrifice would have been ineffective because the employees had the ability to opt out of the scheme at any time and restore their headline rate of remuneration.
- Even if the sacrifice was effective, each assignment undertaken by a temporary employee represented a separate contract of employment for tax purposes so that any expenses incurred were ordinary, non-deductible commuting expenses.

Looking Forward

Salary sacrifice arrangements are widely used by many employers in relation to pension contributions, cars, bicycles, child care and other

benefits and can be of great value to both employer and employee where implemented successfully. However, the *Reed* case serves as an important reminder for employers of the pitfalls of improperly implemented arrangements.

As a basic guide, salary sacrifice arrangements will only be effective where a contractual right to a cash salary payment has been reduced and this requires:

- the potential future benefit to be sacrificed before it is received for tax purposes;

- a revised contractual relationship between employer and employee, the true construction of which is the employee is entitled to lower cash remuneration plus a benefit; and
- the employee must be restricted from opting in and out of the arrangements at will.

In the light of the *Reed* judgment, now may be a good time for employers to review the validity of any existing salary sacrifice arrangements and double check the validity of any planned arrangements going forwards.

Practice group contacts

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