ABI response to Consultation on salary sacrifice for the provision of benefits in kind

The Association of British Insurers

The Association of British Insurers (ABI) is the leading trade association for insurers and providers of long term savings. Our 250 members include most household names and specialist providers who contribute £12bn in taxes and manage investments of £1.6trillion.

The ABI's role is to:

- Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
- Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
- Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
- Promote the benefits of insurance to the government, regulators, policy makers and the public.

INTRODUCTION

The ABI welcomes the opportunity to comment on the Government consultation on salary sacrifice for the provision of benefits in kind.

In our response we focus on those issues which impact on insurers. Insurers have an interest in the outcome of this consultation from two perspectives:

1. **As employers –** The UK insurance industry provides a range of benefits to the 300,000 people that it employs. The outcomes of this consultation will have a significant impact on whether insurers are able to continue to provide certain benefits.
2. **As insurers providing products affected by this review –** ABI members sell a range of products that will be – directly or indirectly – affected by this review. We would like to make the Government aware of the risks of taking steps that could cause damage to overall demand for some of these products, therefore harming levels of financial resilience and running counter to Government policy objectives.

EXECUTIVE SUMMARY

1. Whilst the exclusion of pension contributions from the policy is welcomed, the Government needs to go further to make sure that these proposals do not conflict with encouraging employees to take responsibility for providing protection for themselves and their families, in the event of loss of income as a result of illness or on death . Such conflict will arise if Excepted Group Life policies (EGLP) and Group Income Protection (GIP) policies are not taken out of the scope of these proposals.

2. In particular, the proposed changes run counter to the Government's desire to help employers manage long term sickness absence and its impact on individuals, employers and society, as well as efforts to reduce the disability employment gap. The rehabilitation services provided as part of group income protection are demonstrably effective at improving return to work rates for those absent for health reasons.

3. We are struggling to understand why, if a benefit in kind is not taxable under normal principles, it should become taxable simply as a result as being provided under salary sacrifice arrangements. The effect of doing so would be to increase the cost to employers of providing such benefits by the Class 1A National Insurance Contribution rate of 13.8%. It would also increase the tax on employees. This may result in employers ceasing to offer such benefits (and/or employees not taking them up) and may go even further with employers ceasing to offer flexible remuneration packages. If this happens, benefits like health insurance, including Private Medical Insurance (PMI), provided under a flexible remuneration packages may not be offered as widely as it is currently the case, which would directly impact the public finances, as healthcare currently covered by health insurance would fall on the NHS.

4. Where there is a change to the tax/NICs treatment of a salary sacrificed benefit, appropriate grandfathering arrangements need to be put in place to mitigate the (potentially significant) impact on employees and to minimise the administrative burden of making the change on both employers and employees.

5. Therefore, we recommend that any change in legislation should be effective from 6 April 2018 to reflect:
    - that employees may already have made choices about benefits to be received post April 2017 ;
    - the lead-in time for employers to make changes to payroll, flex and other systems.

Answers to the relevant consultation questions

Question 1: Alongside annual leave, are there any other salary sacrifice arrangements that the government should be made aware of that do not strictly involve receipt of a benefit?

Yes. Two prominent examples are Group Income Protection policies and Group Life policies.

When an employer takes out Group Income Protection policies (GIP) to cover prolonged sick absence, employees may opt to salary sacrifice an amount to increase cover (as a % of salary). More details of the operation and the benefits of GIP policies are given in the answer to Question 7 and in Appendix 1. The employee receives nothing other than the employer's promise of continuity of salary in certain circumstances.

A Group Life policy is a contract between the insurer and the trustees. Employees who are insured under the scheme are not entitled to a benefit, as this is only payable on the event of the employee's death.

Question 5: Do you think the government needs to take any steps to mitigate any negative consequences of this change for employees and employers, such as those who may be locked into salary sacrifice arrangements? If responding it would be helpful to understand specific examples and the factors the government should take into consideration.

Appropriate grandfathering is required to ensure that employees who entered into arrangements before the change in legislation are not faced with an (in some cases significant) unexpected tax charge arising from arrangements entered into in the expectation of the current tax and NIC treatment and which, particularly in the case of lease cars, they cannot terminate without incurring heavy penalties. In many cases, for example, car leasing arrangements the scheme will last between 3 and 4 years. Employers will have a variety of start dates for their 'flex year' and the impact will depend on when

that year starts. For example, someone who entered in to a 3 year arrangement in July 2016 will be impacted from 6 April 2017 to 30 June 2019.

We think that applying grandfathering where an employee entered into the arrangement before a certain date and is committed to the arrangement for a pre-defined period not exceeding 60 months would strike the right balance between meeting HMRC's goals and avoiding unexpected tax bills. In any event, HMRC needs to announce details of any grandfathering arrangements as soon as possible, and not later than the Autumn Statement, so that employers with flex years starting on or after 1 January 2017 are able to give clear advice about tax treatment to their employees.

Question 6: Do you consider that the approach proposed for legislation would work as intended?

Pension contributions are excluded from the policy because the Government wishes to encourage their provision by employers to employees. That encouragement should also be extended to the provision of a lump sum benefit and/or the provision of a pension to the spouse or other dependents when an employee dies whilst still in employment. Whilst in many cases that provision will be via a registered pension scheme that will not always be the case. For an increasing number of employees cover is provided via an EGLP which has no direct link to a registered pension scheme. Section 307 ITEPA 2008 removes liability to income tax under Chapter 10 of Part 3 of that Act from the provision by an employer of retirement and death benefits, including those provided by way of EGLP. The current tax treatment should be retained for all provision falling within Section 307.

If the current treatment is not retained it could result in employers ceasing to offer (and/or employees no longer taking up) EGLPs in view of the additional NICs and tax cost. The consequences of this would be lower levels of financial protection for households. This should be of particular concern for the Government given that a survey by the Money Advice Service has found that around half of working families have no life cover in place.

Question 7: Are there any consequences the government has not considered in proposing to legislate in this way?

As the consultation document reflects, flexible benefits packages are becoming increasingly popular allowing employees to access remuneration packages which meet their lifestyle needs, including the need to protect their family, childcare, health screening, gym membership, green cars. Many of these have positive social and economic outcomes, as well as a positive impact on the employee. Employers may choose to discontinue offering benefits which are subject to the new rules and, if restricted in this way, flexible benefit schemes in general may become less desirable for employees and employers alike. This will have a knock on effect on those items for which the Government wishes to retain salary sacrifice incentives. For example, these could impact products like private medical insurance and cash plans, with the result that there is an increased burden on the NHS. Some of the potential unintended consequences of the changes are outlined below.

<u>Disability and income protection</u>

The UK has a substantial Disability Protection Gap (i.e. the difference between the need to replace a proportion of income on disability and the total cover held). In annual benefit terms, this currently stands at £200bn, approximately three times the cover already in place under employer-provided arrangements and retail policies combined.

Appendix 1 gives more detail about the operation and benefits of GIP policies used by employers to provide cover through the workplace. This cover amounts to 80% of all insured income protection cover. Some schemes include a mechanism where the scheme member is able, using a very simple

application process, to purchase additional cover. In some cases, this may involve a (modest) degree of salary sacrifice.

When a claim is made under a GIP policy, the proceeds will be paid to the employer and used to fund all or part of the employee's salary. Operating PAYE on 'salary' funded by a claim under a GIP policy would be complex if there was a need to identify which part of a GIP claim arose from the employer's contribution to the premium (taxable) and which part arose from an employee's contribution paid via salary sacrifice (exempt).

This uncertainty may result in employers ceasing to offer such benefits (and/or employees not taking them up). If this happens, there would be an impact on the public finances as the amounts covered by insurance would fall on the state. Furthermore, any negative impact on GIP would appear to be at odds with the Government's policy objectives in the work and health space. The Government is expected to publish a Green Paper on work and health towards the end of the year, the purpose of which is to help employers to reduce their levels of long term sickness absence. Reducing sickness absence is fundamental to driving higher levels of productivity in the UK.

Removing the tax and NI benefits for GIP and GL schemes could have a significantly detrimental impact on the achievement of the Government's objectives.

Health screening

Health screening has a vital role in making employees aware of health issues and providing advice both on how to dealing with health problems identified and preventing problems from arising in the first place. As well as improving people's quality of life by giving them a chance to prevent illnesses from occurring or, when an illness has occurred, for the most effective treatment to be started as early as possible, it also helps to reduce pressure on the NHS. The proposed changes to salary sacrifice could potentially discourage employers wishing to provide this service to their employees.

Car leasing arrangements

There will be a significant impact on employees with car leasing arrangements, particularly those who elected for cars with lower CO2 emissions where the difference between the taxable BiK and salary sacrifice is greatest. The greater impact on green cars goes against the intention of the original legislation and the Government's current consultation on 'Company car tax for ultralow emission cars' which states that 'the average company car ownership is three years, after which most are sold to the public, which in turn helps drive lower emissions across the whole UK car fleet'. Without this incentive, fewer employees would invest in a new green car and that 'trickle down' effect would be lost.

Question 8: Would this timeline present employees with difficulty, for example with updating payroll software?

As recognised in HMRC guidance, salary sacrifice arrangements must form part of the employee's contract with their employer. Any changes to those arrangements will need to be reflected by changes to HR systems.

Employers are already actively planning, and putting in place arrangements for, flexible benefits which employees will be able to access after 6 April 2017. The lead in time for a flexible benefit arrangements is a minimum of 6 months, with the following steps required:

- The employer agreeing and sourcing benefits to be provided.

- Setting up the platform window providing webtext and other information necessary for the employee to make an informed decision about the benefits available (a description of the benefit, tax treatment etc.). Rates and net costs will be tested as part of this process.

- Communicating with employees before the selection window opens, ensuring that they understand the products they can buy.

- Opening the employee selection window and leaving it open long enough for employees to consider their choices. This needs to be sufficiently long, e.g. at least a month, to provide access for people who may be on holiday for part of the window.

- Putting the benefits in place. One-off benefits, e.g. health screening, will be provided at some point during the flex year.

To avoid administration complexities, an employer will usually only permit its employees to (re)consider their cover once per year. A 6 April start without any grandfathering would mean that employers who are part way through a flex year would feel obliged to allow (re)consideration. This would involve the considerable administrative burdens of

- Updating employees.
- Updating webtext and other material.
- Updating administrative systems.
- Updating insurance contracts.

For this reason, the grandfathering arrangements referred to in the answer to Q5 should ensure that the net costs for all employees who have already made selections do not increase until the next annual selection window opens when employees are able to see the new net costs of benefits. This is particularly important for one-off benefits where the timing of delivery, which may not be in the employees' control, could result in an increased tax bill for the employee and an administrative burden for the employer.

Appendix 1. Group Income protection

Group Income Protection (GIP) provides a replacement income to those unable to work due to illness or injury. There are around 17,000 GIP schemes currently in the UK covering 2.1 million employees. These schemes cover a range of sectors including manufacturing, leisure, and legal and financial services. Employers providing GIP schemes can be SMEs or larger businesses.

Far too many households in the UK are financially exposed to the risk of having to leave work due to illness of injury. Research by the Centre for Economic and Social Inclusion carried out in 2014 found that around 60% of households in the UK would lose one third of their income if the main earner had to leave work, and a further 40% of households would lose over half. Greater take up of income protection would help to improve the safety net for this group.

As well as providing a replacement income to those unable to work, GIP also provides practical support to help employers reduce levels of sickness absence. Insurers provide vocational rehabilitation to those that have to leave work due to illness, as well as preventative support through Employee Assistance Programmes (EAPs) and training for line managers on how to help employees with health problems.

These services have a track record in reducing levels of sickness absence. The most recent evidence from insurer Canada Life's early intervention service shows that last year 8 out of 10 early intervention referrals led to recovery before the claims stage and that, where claims were made, early intervention shortened their duration substantially. Unum, another insurer, supported 1,470 people with its rehabilitation service last year.

In the context of an ageing workforce, in which an increasing proportion are disabled or suffer from chronic conditions, GIP can play an even greater social role. The Government has set itself the ambitious target of halving the disability employment gap. Meeting this target requires increasing the number of disabled people in work by 1.5 million by 2020. As the Resolution Foundation argued in its report *Retention Deficit*, this can only be achieved by dramatically reducing the number that leave work due to health problems and find themselves on long term sickness benefits. Greater take up of GIP would help to deliver this.

The cumulative impact of the support currently provided by the income protection market is substantial. Last year, income protection insurers paid out a total of £478 million in claims to individuals who were unable to work. An economic analysis carried out by Kyla Malcolm on behalf of Zurich found that the current GIP market delivers £192 million of fiscal savings annually in the form of increased tax revenue and lower spending on disability benefits.