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BEIS Consultation: National Minimum Wage – Salaried hours and salary sacrifice

Response from the Employment Lawyers Association

1 March 2019

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Introduction

The Employment Lawyers Association ("ELA") is a non-political group of specialists in the field of employment law and includes those who represent Claimants and Respondents in the Courts and Employment Tribunals. It is therefore not ELA's role to comment on the political merits or otherwise of proposed legislation, rather to make observations from a legal standpoint. The ELA's Legislative and Policy Committee is made up of both Barristers and Solicitors who meet regularly for a number of purposes, including to consider and respond to proposed new legislation.

A working party, co-chaired by Jonathan Chamberlain of Gowling WLG and Stephen Ratcliffe of Baker & McKenzie was set up by the Legislative and Policy Committee of ELA to respond to the consultation document issued by the Department for Business, Energy and Industrial Strategy on salaried hours and salary sacrifice. The working party members are listed at the end of this paper.

Question 1 - Should the Government amend Regulation 21 (5) to allow other payment cycles?

Yes

Question 2 - If you answered yes to the question above, what payment cycles should be permitted in the regulations?

a) Fortnightly?

Yes

b) Four-weekly?

Yes

c) Any equal and regular period of one month or less?

Yes

d) Any other payment cycles?

No. We are not aware of any other payment cycles used by employers not otherwise catered for.

Question 3 - Would the inclusion of additional payment cycles assist employers to comply?

Yes.

There are some employers who pay on a fortnightly or four weekly basis because of historic practices. However, they cannot currently categorise those workers as carrying out salaried work. Some may mistakenly be doing so which could result in them unknowingly failing to comply with National Minimum Wage legislation.

We do not see any good reason why those employers should not be able to treat workers paid on additional payment cycles, for example a fortnightly or four weekly basis, as carrying out salaried work. That is how most employers would naturally think of workers who are paid on those cycles and who otherwise satisfy the requirements of salaried hours work. In order to protect workers, we agree that this should only apply in circumstances where the payment cycle is an express contractual entitlement/requirement.

Question 4 - Would the inclusion of additional payment cycles cause any detriment to workers?

Additional payment cycles described above (i.e. which are under a month in duration) should not, in our view, cause any detriment to workers, so long as the payment periods are clear and expressly set out in the contract.

Question 5 - Do any of the other conditions for salaried hours work listed overleaf lead to unintended consequences?

We would request that statutory code of practice or binding guidance is provided in respect of the concept of "hours in a year… ascertained in accordance with their contract" under Regulation 21(3) National Minimum Wage Regulations 2015. This condition can cause complications for employers because of the unusual manner in which it has been interpreted by HMRC in some cases. Most contracts where workers are paid a salary state what the worker's normal weekly working hours will be. However, HMRC has on occasion suggested that such contracts do not satisfy Reg 21(3) because a reference to weekly hours can only account for 364 days of the year, not the 365th day of the year. What the basic annual hours are will therefore depend on whether the 365th day is a working day or not. There is also the issue of how the 366th day of the year in a leap year should be treated.

Such an interpretation is overly technical and liable to cause confusion and concern about the motives behind such an interpretation, particularly if its effect is to render otherwise compliant employers non-compliant. It is for this reason that we would suggest the introduction of statutory guidance to confirm the approach employers should take to ascertaining the basic annual hours and evidencing them. Furthermore, we would respectfully request that HMRC take a common sense approach to such issues, bearing in mind commonly-used formats for stating basic hours in employment contracts.

ELA would also request that consideration is given to reviewing Regulation 21(4) regarding the sorts of payments which workers can receive whilst falling within the "salaried hours work" provisions. In our view, there is no substantive reason why the conditions should be limited purely to those workers who receive an "annual salary" and "performance bonus" only; this excludes workers who receive other forms of remuneration including but not limited to attendance bonuses. Similarly, a worker paid a salary and monthly performance incentive (common in a sales and service environments) can inadvertently be classed as an "unmeasured" worker simply because the incentive payment falls within a single pay period (which may happen for a reason as simple as the way in which the calendar falls). We see no substantive reason why these additional forms of remuneration should result in workers falling outside of these provisions. We are concerned that this does not reflect modern business practices, and may, in some cases, dissuade employers from permitting such remuneration, in circumstances where no additional protection is then afforded to the worker.

Question 6 - Would the calculation of salaried hours work be easier (for employers, and workers) if regulations set a single uniform 'calculation year' (i.e. the same calculation year for all workers of an employer)? (please give reasons for your answer)

Yes.

ELA notes that the current approach to identifying a salaried worker's calculation year can be administratively cumbersome for employers of all sizes as there are 365 possible reference dates to measure the year. For salaried workers too, we suggest that having a definitive calculation year would provide simplification to enable workers to ensure their employer's compliance.

Question 7 - If you answered yes to the question above, should the single uniform calculation year be:

(a) The calendar year (1 January to 31 December)? (please give reasons for your answer)

No – see response to 7(c)

(b) The tax year (6 April to 5 April of the following year)? (please give reasons for your answer)

No – see response to 7(c)

(c) At the discretion of the employer (but uniform across the whole workforce)? (please give reasons for your answer)

Yes.

ELA consider that is certainly probable that a number of employers would choose, for obvious reasons, to align their calculation year with the tax year. This may also be preferable for workers, particularly in the case where basic annual hours are exceeded and the worker is then paid for additional hours worked in that calculation year/ tax year.

However, it is ELA's view that employers should be given discretion to determine their calculation year to best align with their business. ELA considered, for example, that employers (and, indeed, workers) within the education sector might wish to set the calculation year to align with the academic year (1 September to 31 August).

Whilst ELA would advocate reducing complexity of the approach to the calculation year, ELA also considers that there may be employers (particularly larger employers with a diverse workforce) for whom a single calculation year across the 'whole workforce' may be overly simplistic. For local authorities, for example, different calculation years may be appropriate for their centrally-based office staff as compared to school staff (for the reasons already identified above).

Question 8(a) - Do salaried hours work rules cause difficulty for employers while making overtime and premia payments to workers? (please give reasons for your answer)

Yes, we do think the rules cause difficulty for two reasons:

- Complexity - The rules are complicated making it difficult to ensure a compliant salaried work regime. The Regulations, and particularly the HMRC guidance, are extremely difficult to follow in respect of calculation years, hours which 'count' and pay which 'counts' in the context of overtime in particular. This makes it difficult for both employers to ensure compliance, and workers to ensure that their employers are compliant.

- In respect of premia and other payments made to workers, we think that rewarding workers with such incentive payments should not mean that they automatically cannot be salaried. In particular, this creates difficulties for employers in rewarding workers with additional pay whilst ensuring that they maintain an NMW-compliant system without considerable additional administrative burden.

Question 8(b) - Should salaried hours work rules be amended to include overtime and premia payments? (please give reasons for your answer)

- In respect of overtime in the context of salaried hours work, we can see the policy reasons for ensuring that employers are paying employees NMW for their basic hours, rather than relying on overtime to bring that total up. It is currently possible to work and be paid for overtime and we see no reason to change that.

- As regards premia and other types of payment, for the reasons given in (a) above, we think that employers should be able to make these payments without falling outside the salaried hours calculations.

Question 8(c) - Do you think an employer's policy towards offering pay premia would be affected by amending the current rules to allow overtime and premia payments to fall within salaried hours work? (please give reasons for your answer)

Yes. Anecdotally we believe that employers may not be making such payments available to workers because they cannot without falling outside the salaried hours workers calculations, not because they don't want to. That causes difficulties in finding salaried workers to work in locations that are considered less desirable or at unsociable times such as night or early morning. This causes difficulties in many sectors, but particularly in sectors such as health and social care. It creates a situation where there is no incentive for workers to work at these less desirable places or unsociable hours and so they choose not to do so, creating staffing problems for employers. This has a knock on effect of employers having to rely on agency/bank workers, for which they pay a premium. Changing the rules could help to alleviate these problems.

Question 9 - Do you have any evidence that the salary sacrifice offer has been withdrawn or restricted in the last 12 months as a result of National Minimum Wage requirements?

Yes. There are numerous examples of companies which have taken the decision at various times to restrict access to salary sacrifice arrangements to lower paid workers to avoid inadvertently falling foul of the regulations. This can create a two tier workforce within some organisations with regards to access to certain benefits and/or the provision of such benefits on a legitimately tax advantaged basis. Three of the most glaring examples of the issues caused by the exclusion of salary sacrifice benefits from minimum wage calculations are:

- Making pension contributions by way of salary sacrifice could breach the NMW Regulations meaning that the lowest paid staff (for whom pension contributions are mandatory and increasing due to auto enrolments regulations) have to cease a salary sacrifice in favour of a standard pre-tax deduction. This forfeits the NI benefit otherwise available to the employee meaning that the contribution costs more to the workers who earn the least.
- Childcare vouchers are a very valuable tax efficient benefit to many lower earning employees and, once again, where a deduction for these creates a risk to breach of NMW the tax benefit may need to be removed from those people at the lower rand of the earnings range, costing them more to meet their basic needs.

- Holiday purchase schemes are a very common part of the benefits offering of many large employers. This is also a very challenging benefit to provide to "unmeasured" workers due to the lack of availability of pay averaging. In principle, this should be a very straightforward benefit as it is simply a reduction in hours for a reduction in the corresponding annual pay, over a 12 month period, but for "unmeasured" workers it carries an inherent risk of NMW non-compliance.

Question 10 - What do you regard as the main reasons that workers opt in to salary sacrifice schemes? Tax efficiency/Easier way to purchase benefits/None/Another (please specify)

We believe that reasons why employees opt in to these schemes are:

- to help to manage the cost of mandatory retirement saving in the most tax-efficient manner; and
- to help to manage the cost of an employee's basic needs such as childcare, again taking advantage of legitimate tax efficiencies where they are available,

Question 11 - What, if any, risks to workers' pay do you think are presented by salary sacrifice schemes? (please use examples if you can)

Entering into a salary sacrifice scheme naturally reduces pay received in the employee's hands. Generally, such schemes have limited opt-in and opt-out periods, such that a decision made to limit pay in this way will be a lasting decision in many cases (at least until the next enrolment window). There is therefore an inherent risk that employees may reduce their pay to below an acceptable level and later change their minds, without an ability to reduce the level of sacrifice for some time. However, we have seen no examples of this having caused hardship in practice, since employees are generally well-informed about the lasting effect of a salary sacrifice decision.

Question 12 - Are there any other National Minimum Wage rules which penalise employers without protecting workers from detriment?

We would make a number of recommendations in this regard.

In addition to those specific points made below, we would make the general point that it is the experience of ELA that employers are not generally seeking to avoid compliance with minimum wage legislation. However, it is very common indeed for employers (even those paying considerably above NMW) to be inadvertently caught out by the complexity of the legislation and its interpretation. Bearing in mind the purpose of the legislation is to ensure compliance, and not to catch employers out, the complexity inherent in it, and the perceived-agressive nature of enforcement activity in some cases, can lead to non-compliance where, if the provisions were simpler and HMRC's approach more collaborative, no such non-compliance would arise.

ELA are of the view that employers would benefit from greater clarity regarding how the NMW Regulations are applied, particularly with regard to ensuring a consistent approach from HMRC across the country. This could take the form of a statutory code of practice or other binding guidance. we have referred in Question 5 above to a particularly surprising interpretation of one section pursued by certain HMRC inspectors. We consider that such surprises might be avoided if such guidance were to be provided.

Time Off in Lieu ('TOIL')

We are aware of some employers who are concerned that a lack of clarity in relation to the impact of "time off in lieu" working on NMW compliance means that they must withdraw this despite it being a working arrangement which employees value.

The problem is particularly acute where time off in lieu cannot be taken in the pay reference period (a common issue where pay reference periods are only a week or a fortnight but true to a lesser degree for monthly pay reference periods).

This is a particular issue for hourly paid workers but can also be a problem for salaried workers if the effect of TOIL is not simply to regulate employees' hours such that they only work their basic hours over the course of the year. Anecdotally it is our members' experience that TOIL is a system which many employees find helpful to allow them to manage family and obligations.

Deductions

We believe that statutory guidance is required in respect of which deductions from pay "count" towards the NMW calculation. The current rules and cases are confusing and make it difficult for often well-meaning employers to comply with the provisions (and for advisers to advise with confidence on any given remuneration/benefit arrangement).

There have been recent examples of deductions made by employers, which workers have elected to have made and are for their benefit, which resulted in HMRC forming the opinion there was an underpayment of National Minimum Wage. Those recent examples include deductions for employee savings schemes, football season tickets and insurance benefits. Whilst we appreciate the need to protect workers from compulsory deductions under which they receive no real benefit, in many cases, such deductions are being made on an entirely voluntary basis and workers genuinely benefit from and want such benefits to continue. For example, the deduction for a savings scheme helped workers spread the cost of Christmas over the course of the year (albeit that the employer also deferred certain salary costs until the end of the year). The deduction for a football season ticket helped the worker spread the cost over the course of the year.

We have seen similar examples of employers who allow employees to obtain discounted access to their own goods and services via deductions from pay. We understand that such schemes are often operated in this way by employers as it would often not be administratively feasible to offer such discounted schemes via a payment from the employee (and therefore permissible under regulation 12(2)(e)), rather than via a payroll deduction. So long as there are appropriate protections and safeguards in place to ensure that employees are genuinely opting in to an arrangement with their employer of their own free will, we do not believe that it makes sense to restrict access to benefits in this way. We have seen examples of this leading to the surprising outcome as part of a NMW compliance review whereby an employer is required through a Notice of Underpayment to pay to an employee an amount of "underpayment" in circumstances where the employee has already received goods or services of that value.

As a result of these issues, we are aware of examples where access to these additional benefits has been withdrawn or restricted from lower paid groups to avoid any inadvertent breach of the NMW Regulations (and therefore to avoid any obligation to repay to employees the cost of goods and services they have already received). Again, this is creating a 'two tier' workforce within some organisations and is restricting access to certain benefits to those employees who would potentially benefit from them most.

Rest Breaks

We do not believe there should be a difference between how rest breaks are treated for "time work" and for "unmeasured work". Workers have no legal right to a paid break. They only have the right to an unpaid break. Despite this, some employers pay their workers during their breaks. If a worker is carrying out time work, the pay they receive during their break cannot be taken into consideration for the purposes of NMW compliance (Regulation 10(h)(i)). For workers carrying out unmeasured work, the pay they receive during a break can be taken into consideration for the purposes of NMW compliance.

It seems unfair that an employer who pays their workers carrying out time work for breaks when there is no legal requirement to do so cannot count this payment towards NMW compliance. This might have the effect of employers only providing unpaid breaks to the detriment of workers carrying out time work, because they will lose a paid break.

Overtime

Where a salaried worker works additional hours and is paid overtime, that overtime is likely to be time work, the calculation for which can be very different to the calculation for salaried work. In particular, different wage types and deductions are taken into account for the purposes of calculating 'pay' for

NMW purposes. To have to perform two calculations each month for the same employee each considering different elements of pay is arguably unnecessarily complex. We believe that consideration should be given to simplifying the calculations required in these circumstances so that all 'pay' is treated in the same way in order to assess compliance.

ELA Working Party

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