Rewarding employees: how to reduce tax liabilities

Employment Tax



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How much festive cheer can employers spread without incurring tax liabilities? And how can they support employees all year round?

Key Points

What is the issue?

Employers should be aware of a range of seasonal tax issues to ensure compliance and make the most tax-efficient decisions.

What does it mean for me?

Alongside the provision of trivial benefits and making use of the annual events exemption, there are several other ways to reward employees while also making use of certain tax rules.

What can I take away?

It is possible to put together a package of tax efficient benefits to ease the financial burden for employees, including employee parking, employee assistance programmes, staff discounts, holiday buy back, birthday vouchers, Christmas gifts and additional homeworking costs.

During the festive season, employers will inevitably be thinking about rewarding their employees by way of Christmas presents and/or a Christmas party. Employers should be aware of a range of seasonal tax issues to ensure compliance and make the most tax-efficient decisions.

Christmas presents

Typically, giving an employee a gift of any sort would in theory be a taxable benefit. Thankfully, parliament has decided to be a little more generous, and it is possible for employers to rely on the ‘trivial benefits’ exemption.

For a benefit to be trivial it must meet the following criteria:

- the cost of providing the benefit does not exceed £50;
- the benefit is not cash or a cash voucher;
- the benefit is not provided under salary sacrifice arrangements or any other contractual obligation; and
- the benefit is not provided as a reward for services.

The trivial benefits exemption can apply to any other gifts provided to employees throughout the year where the conditions are met. This could apply to Easter eggs, wedding presents, new baby presents, and so on. They cannot apply to any thank you gifts, as these would be classed as a reward for service.

Care also needs to be taken, as HMRC can challenge anything provided regularly under the trivial benefit exemption, as it might create a ‘legitimate expectation’. An example could be payday drinks. HMRC can argue that this expectation means that the trivial benefit exemption will not apply.

Where employers wish to provide any gifts above £50 in value, this can still be done without a taxable benefit arising for the employee. However, these would need to be included in a PAYE Settlement Agreement, where the employer would pay the tax due on the benefit, on a grossed-up basis, on the employee's behalf.

There are additional rules for directors and other office holders of close companies, who will be subject to an annual cap of £300. Where the benefit is provided to a member of the employee's family or household who is not an employee of the employer, this benefit will count towards the £300 exempt amount. Where the director or office holder's family or household member is also an employee of the company, they will also be subject to a £300 cap.

Christmas parties (and other annual events)

The provision of a staff Christmas party would generally be considered as staff entertainment and therefore a taxable benefit. However, HMRC has an annual events exemption, meaning that if the annual event meets certain conditions, it is exempt from tax arising from the benefit provided. The conditions are: it is an annual event; it is open to all employees; and it costs less than £150 per head.

This exemption can be spread over different events, such as a summer barbecue and a Christmas party. However, the cost per head of both events combined must not be over £150. Where this is the case, only one event will be eligible for the exemption, and the other must be reported through a PAYE Settlement Agreement.

The cost per head is reached by considering every cost that goes into the event, such as the venue, food and drinks. It will also include any overnight accommodation and transport provided, and the amount must include VAT. The total cost is then divided by the total number of attendees, including any non-employees.

If the business has more than one location, an annual event that is open to all staff based at one location is still 'open to all'. Employers can put on separate parties for different departments if all of the employees can attend at least one of them.

Other tax-efficient rewards

The cost of living crisis has led many employers to think about how they can support their employees all year round, not just at Christmas. Alongside the provision of trivial benefits and making use of the annual events exemption, there are several other ways to reward employees while also making use of certain tax rules.

By thinking creatively, it is possible to put together a package of tax efficient benefits that may help to ease the financial burden for employees. This could include employee car parking, employee assistance programmes, staff discounts, holiday buy back, birthday vouchers, Christmas gifts and additional homeworking costs. However, the rules relating to tax efficient benefits can be complicated and employers must meet strict conditions for any benefit in kind charge to be avoided.

Provision of food at work

Something that is easy to introduce, and which may have a significant impact on employee wellbeing, is providing food at work. This provides more value for the financial investment involved than one-off cash payments, as money spent on food for employees is not subject to tax and NICs.

Various criteria must be met to avoid tax and NICs deductions on food at work. For every £100 pay given to an employee, it will be subject to tax and NICs. If £100 is spent on food for employees, it will not be subject to any such deductions if the relevant criteria are met.

The canteen exemption

Tax law permits that subsidised meals on the employer’s premises or in a canteen can be provided for free, without any tax implications. That is provided the following conditions are met:

- All employees must have the option of a free meal (whether or not they choose to take up the offer).
- The meals must be available to all employees at a particular site (but do not have to be available at all the employer’s sites).
- The meals must be provided in a canteen (could be off-site) or on-site (for example, the kitchen or at reception).

- Meals must be on a ‘reasonable’ scale.
- Meals cannot be provided in conjunction with a salary sacrifice arrangement or flexible remuneration arrangements.

This would not apply to any food provided that HMRC would deem to be ‘staff entertaining’ – for example, pizza and alcohol in the office after work – unless covered by the annual events exemption limit of £150. Nor can the exemption apply to reimbursements to employees for the cost of food brought into the office.

This still leaves a lot of scope for employers. Where there is a canteen, the employer can simply provide meals for free. If not, an employer could leave lunch bags on reception for employees if all are invited to take the meals.

Interest-free loans

Many businesses already provide loans to help employees spread the cost of annual travel season tickets. However, this approach could also be used to provide hardship loans to help employees pay for heating bills, for example. Considerations here include the employee’s ability to repay the loan and the value of the loans being offered. Tax rules specify that employers can provide tax-free loans of up to £10,000, without incurring a benefit in kind.

Salary sacrifice

Salary sacrifice schemes allow employees to agree to a reduced salary in exchange for a benefit. The benefit is exempt from a benefit in kind charge if it is: payments into pension schemes; employer provided pensions advice; workplace nurseries; childcare vouchers and directly contracted employer provided childcare that started on or before 4 October 2018; or bicycles and cycling safety equipment. This can be a tax efficient approach offering significant tax and NICs savings. These savings result from the benefit being exempt from, or incurring lower, tax and NICs charges than the amount of salary given up.

Electric vehicle schemes are particularly popular now, offering employees a tax efficient benefit, reduced fuel costs and in some cases free installation of a charging point.

Other benefits are taxable based on the higher of the salary given up or the taxable amount under benefit in kind rules.

Employee suggestion schemes

Employee suggestion schemes are programmes designed to encourage employees to share their ideas, suggestions and solutions to enhance the operations, processes, products or services of a company. Cash rewards to employees are usually subject to tax and NICs; however, through an employee suggestion scheme, they may be exempt from tax and NICs.

There are two kinds of award under employee suggestion schemes, which must be open to all staff. The first are encouragement awards for good suggestions or to reward employees for special effort. To remain exempt, the value of this type of reward must not exceed £25. The other type are financial benefit awards for suggestions that will save or make the business money. If the suggestion results in a financial benefit for the company, then financial benefit awards are exempt from tax and NICs, with an upper limit of:

- 50% of the money the suggestion is expected to make or save the business the year after it is put into action; or
- 10% of the money it is expected to make or save in the first five years.

The exemption for financial benefit awards has a maximum limit of up to £5,000 regardless of the financial benefit for the company. However, not all types of rewards are eligible for tax exemptions. For instance, any rewards that are given as part of an employee’s contract of employment or within the scope of their normal duties will be subject to income tax and NICs.

Employee suggestion schemes serve as a tool to unlock the potential of a company’s workforce but it is essential to ensure compliance with tax and NICs regulations.

Rewards are not just for Christmas

Christmas gifts and Christmas parties are always welcomed by employees as an enjoyable way to end the calendar year, and as a show of appreciation by their employer. By thinking outside the box, employers can provide employees with a wide range of exempt or tax efficient benefits throughout the year. The ideas mentioned above can really help with staff retention, motivation, and job satisfaction.

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