Balancing benefits and compliance: the National Minimum Wage

Employment Tax | OMB | Large Corporate



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With increased Minimum Wage rates due in April 2025, we consider the risks that can threaten compliance with the legislation.

Key Points

What is the issue?

With increased rates due in April 2025 and heightened compliance activity from HMRC, National Minimum Wage compliance is a hot topic for employers. Employers must assess their workers' categorisation for NMW purposes, such as undertaking time work, salaried hours work, output work or unmeasured work. Incorrect categorisation can also lead to underpayment and non-compliance.

What does it mean for me?

Salaried workers with a set annual salary and minimum weekly hours are often miscategorised. Employers must ensure they meet the criteria for salaried hours work and correctly calculate excess hours worked beyond the annual hours. Salary sacrifice schemes can also lead to NMW underpayment if not carefully monitored.

What can I take away?

Employers should prioritise compliance by regularly reviewing processes, worker categorisations, rates and eligibility, inclusions and exclusions, and record-keeping.

The National Minimum Wage (NMW) came into force under the Labour government in 1999. Interestingly, some form of wage control has been in existence since the Fair Wages Resolution of 1891. The National Minimum Wage Act 1998 also provided a statutory framework for the Low Pay Commission, which was set up in 1997 and which makes recommendations on minimum wage rates and other aspects of the minimum wage regime. With increased rates due in April 2025, the phasing out of the wage band for those above 18 and heightened compliance activity from HMRC, the NMW is a hot topic.

It is therefore advisable for employers to keep on top of NMW compliance, noting that any buffers they had in hourly pay are likely to reduce. However, employers should not only be closely monitoring those staff who are paid near to NMW rates. In our experience, employers often neglect to consider those who are more highly paid, which can prove a costly mistake.

Here, we explore the intricate balance between offering attractive benefits and maintaining NMW compliance, particularly focusing on the implications of salary sacrifice and the impact of excess working hours on salaried employees – two of HMRC’s top five risk areas.

The other three risk areas are: additional working time; interns and volunteers; and the number of weeks in a year for calculations, which could be considered to be one of the following options:

- 52 x 7 = 364
- 52.14 x 7 = 364.98
- 52.18 x 7 = 365.26
- 52.2857 x 7 = 366

Where employers are found to have been underpaying the NMW over the previous six years, they must pay the arrears back to the underpaid workers (including ex-workers) and can face penalties of up to 200%. The Department for Business and Trade will also publish the names of employers who fail to comply with NMW laws as a deterrent to others.

Worker categorisation is critical

The first step that employers should undertake for compliance is an assessment of their workers to identify which worker categorisation they fall into for NMW purposes. Without undertaking this exercise, the employer can't know what NMW calculation methodology to apply. The main categories include:

- **Time work:** Workers paid by the hour must receive at least the NMW for each hour worked.
- **Salaried hours work:** For workers with a contract for a basic number of hours each year and an annual salary, their pay must be divided by the total hours worked to ensure that they meet the NMW.
- **Output work:** Workers paid by the piece or task completed must receive at least the NMW for the total hours worked, calculated based on the number of pieces produced.
- **Unmeasured work:** Workers whose hours are not measured, or not easily measured, must have their pay calculated to ensure they meet the NMW for the estimated hours worked.

If a worker is incorrectly categorised, they may not receive the correct NMW rate, hours worked may be incorrectly recorded, payments may not be made in the correct pay reference periods, or processes and controls used to track compliance by the employer may be incorrect.

Why are salaried workers a risk?

Many workers receive an annual salary based on a minimum weekly number of hours, typically between 35 and 40. However, it is a common misconception that they automatically qualify as performing salaried hours work for NMW purposes. To qualify, the criteria outlined in Regulation 21 of the National Minimum Wage

Regulations 2015 must be met. HMRC provides a ‘Flowchart to decide if salaried hours work applies’, summarising these rules, at National Minimum Wage Manual NMWM07025 (see tinyurl.com/ycy2svzh).

The rules were amended on 6 April 2020 by the National Minimum Wage (Amendment) (No. 2) Regulations 2020, with transitional provisions for recategorised workers. For these workers, the amended conditions apply from the start of their first calculation year, beginning after 6 April 2022.

Consequently, employers should have reassessed their NMW compliance during this period to ensure that all workers met the criteria and understood the applicable calculations, as well as establishing the category for any new workers after this date.

The advantage of a salaried hours contract is that it provides consistent pay and hours across each weekly or monthly pay reference period, regardless of the actual hours worked within the pay reference period. If an employee exceeds their annual hours during the year, however, they must be paid at least the NMW for each excess hour worked.

Similarly, if an employee leaves part-way through their calculation year, the employer must ensure they have not been underpaid. This is particularly relevant for sectors with significant seasonal fluctuations in work demand, and causes employers confusion around the processes and controls needed to obtain compliance for this group of workers.

For salaried workers, the main risk identified in HMRC reviews, particularly from the second half of 2022 and early 2023, has been the calculation of excess hours. What is the excess hours calculation? For salaried hours workers, compliance is evaluated over the course of the worker’s ‘calculation year’, which means that the worker must receive at least the NMW for their total hours worked during this period. While most salaried workers may not breach requirements in individual pay periods where additional hours are worked, a breach could occur when considering the entire year, often in the last pay period. This annual review is a complex calculation.

Unless a ‘standard’ calculation year is chosen and notified by the employer (as per the National Minimum Wage Regulations) and agreed upon with workers, working time may need to be assessed over an annual period for each individual worker, typically based on their employment start date. This could require the employer to

manage up to 366 different definitions of ‘a year’ for their employees.

How you monitor for excess hours can involve a number of requirements. HMRC provides guidance at MNWM08133, where it gives examples of calculating excess hours where the basic hours are exceeded in a pay reference period (see tinyurl.com/4eya6ec).

A critical question arises: how many employers track the actual working time of salaried employees? Without this, it is impossible to perform an excess hours calculation and accurately check for compliance with the NMW. The prevalence of remote and hybrid working, where the capturing of working time is more difficult, complicates this further.

Why is salary sacrifice a risk?

A salary sacrifice arrangement involves an employee agreeing to a reduction in their cash pay in return for a non-cash benefit. Common examples include additional pension contributions, cycle to work schemes and childcare vouchers. These schemes can be beneficial for both employers and employees, offering savings on tax and National Insurance contributions. However, because they reduce a worker’s pay, they can also lead to NMW compliance issues.

In December 2018, the government initiated a consultation to examine the impact of NMW rules on salary sacrifice schemes. The consultation aimed to determine whether employers were withdrawing salary sacrifice benefits from low-paid workers to avoid breaching the legislation.

The government’s response was published on 11 February 2020, and revealed that 55 out of 101 respondents were either withdrawing or restricting salary sacrifice schemes due to NMW requirements. However, the government decided against amending the legislation to permit workers to accept pay below the NMW, citing the risks to workers and the potential for exploitation as outweighing the benefits.

In May 2024, in response to a written question, Kevin Hollinrake MP confirmed that the government had no plans to amend the legislation to allow salary sacrifice arrangements or deductions that reduce pay below the NMW. Employers must therefore ensure that they monitor the impact of all salary sacrifice schemes on

NMW compliance carefully. We often find that these checks are undertaken by payroll, but this only forms part of the compliance picture. Employers must have processes and controls to ensure that entry into a salary sacrifice scheme will not create a NMW risk, and consider the aggregate effects of all salary sacrifice schemes that the worker may be seeking to take part in.

Where it looks like a breach may occur, the employer may choose to prevent the worker from joining the scheme in the first instance, or impose a limit on the amount the worker can sacrifice. It may also result in the need to report the benefit in kind for tax purposes differently.

To demonstrate a real-life example, a worker is paid an annual salary of £45,000 and is contracted to work 40 hours per week. If they participate in their employer's salary sacrifice pension and sacrifice 6%, working a single hour of unpaid overtime each day would mean they would exceed their annual hours in month 11, and would breach the NMW by month 12 if they were a salaried worker and no top-up payment is made. Had this worker been categorised as performing unmeasured work, there would be no excess hours' calculation and no breach of NMW. This reinforces the need for employers to not only review their worker categorisations, but also to decide which is most appropriate when considering the type of work they do and the NMW compliance requirements.

What should employers do?

Ensuring NMW compliance should be a top priority for all employers, and it should also be added to risk registers. It's complex and therefore easy to make mistakes. Given the penalties which apply, and the potential reputational damage which can be caused through naming and shaming, employers should regularly review their processes and procedures, making swift changes if any breaches are identified.

The key aspects that employers should be aware of when monitoring NMW compliance fall into the following areas:

- worker categories;
- rates and eligibility;
- inclusions and exclusions;
- record keeping; and

- training and updates on legislation and case law.

Keeping on top of these, undertaking regular reviews and seeking advice when needed will go a long way to mitigating the risk of a breach.

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