Standard Life

Pension Post

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Salary sacrifice and employer pension contributions

In this Pension Post we look at salary sacrifice arrangements and employer pension contributions.

Tax law imposes a benefit in kind (BIK) income tax charge when an employee forgoes part of their contractual remuneration in return for a benefit provided by the employer, except for some limited circumstances like the provision of travel passes. This can result in some employer pension contributions being taxed as if they were employee contributions.

Example

An employee of a multinational has a contract of employment which provides for a fixed salary and the payment of a variable bonus each year, to be determined by the employer based on certain criteria.

The company has had a good year and the employer is going to pay the employee a bonus of 40% of their salary. However, the employee suggests that instead of paying the bonus, the employer pay the same amount as an employer's pension contribution for him or her.

Is this ok?

No, it's not. What should happen is this:

- Section 118B Taxes Consolidation Act 1997 provides that this is a 'salary sacrifice arrangement' and the contribution paid to the pension scheme is not an employer pension contribution but an application by the employee of their taxable remuneration, i.e. an employee pension contribution

Revenue in their Tax & Duty Manual 5-01-01k, July 2021, states

> **"Any arrangement under which:**
>
> - **an employee waives an entitlement to remuneration, or**
> - **accepts a reduction in remuneration,**
>
> **in return for a corresponding payment by the employer into a pension scheme, is considered to be an application of the income earned by the employee rather than an expense incurred by the employer. Such arrangements are subject to the taxing provisions under section 118B TCA 1997.**
>
> **In such cases, the employee is instead regarded as having applied a portion of his or her income to the benefit acquired, and remains taxable in full on their 'gross' income under Schedule E."**

The employer should therefore, for tax purposes, treat this payment to the pension scheme as a BIK for the employee and not an employer pension contribution; in effect the employee's taxable remuneration for the year is their salary + the 40% bonus paid as an employer pension contribution.

- The employee can then claim income tax relief (but not USC or PRSI) on this contribution as if it were a personal contribution to the scheme, within the usual age related limits (in this case, based on remuneration of 140% of salary, limited to €115,000 earnings)

The downside of the salary sacrifice treatment where the employer pension contribution is treated as an employee contribution is:

- The employee is liable to USC and PRSI on it, which they wouldn't be if it were classified as a normal employer pension contribution;
- Income tax relief, if obtained, may have to be spread out over a number of years, and in some cases might not be fully claimed by the time the employee leaves service or retires;
- It may crowd out the scope for tax relief on ongoing employee and AVC contributions

Discretionary remuneration

Revenue also look on waiving discretionary remuneration for employer pension contributions as salary sacrifice:

> **"Remuneration is not restricted solely to cash remuneration, but includes all forms of remuneration arising from the holding of an office or employment. This includes bonus payments and any form of discretionary payment."**

When is an employer pension contribution not deemed to be salary sacrifice?

In broad terms, an employer pension contribution to a pension scheme for that employee is not salary sacrifice if it is not funded by the employee foregoing or accepting a reduction of an equivalent amount of remuneration.

Example

The employee has a contract of employment which provides for a salary, bonus and the payment of specific level of employer pension contribution, for example, 10% pa of salary.

The employee's remuneration due under the contract of employment is salary + bonus, and as the employer pension contribution is not being funded by the employee giving up part of their contractual remuneration, the payment of the employer pension contribution is not treated as a salary sacrifice arrangement.

Instead, it is treated as a normal employer pension contribution, which is exempt from a BIK income tax charge on the employee.

Renegotiating contract of employment?

Where an employee has an existing contract of employment with a right to an annual bonus, could it be renegotiated to remove the bonus and instead provide for an increased employer pension contributions without it being treated as salary sacrifice? No, it seems.

Revenue considers the following to be salary sacrifice:

> **"...if an employee forgoes a portion of their remuneration in return for anything other than a travel pass, shares under an approved profit-sharing scheme or bicycle and/or safety equipment by way of any of the following arrangements:**
>
> - **changing the existing terms or contract of employment,**
> - **creating new terms or a new contract of employment, or**
> - **adapting a new practice, not in writing, relating to the terms and conditions of the employment**

It may be possible for that contract to be renegotiated to a new one which contains no right to a bonus, but provides for the employer to pay a variable amount each year to the pension scheme for the employee, which may fall outside the 'salary sacrifice arrangement' tax treatment.

Revenue's view on this in their Tax & Duty Manual 5-01-01k, July 2021, states:

> **"...if an employee forgoes salary payable under an existing contract of employment in exchange for a benefit, the employee remains taxable on the ''gross'' income payable. The salary sacrificed will be considered to be an application of income earned by the employee, not an expense incurred by the employer.**
>
> **...This is in contrast to the position where an existing contract of employment is bona fide renegotiated so as to provide a mixture of the salary and benefits. In those circumstances the employee will be taxed on what he or she gets, i.e. the cash salary plus the taxable value of the benefit-in-kind, provided the new employment contract involves no right on the employee's part to choose between cash and benefits."**

Get professional tax advice

An employee giving up a bonus in return for an equivalent employer pension contribution carries a high risk of being classified by Revenue as a salary sacrifice arrangement and the contribution consequently taxed as an employee pension contribution. This means a USC and PRSI liability on the contribution with income tax relief possibly having to be spread over a number of years, with a risk that all relief will not be claimed by the time the employee leaves or retires.

Professional tax advice should always be sought by clients before implementing any proposal to fund an employer pension contribution by way of a variation of existing contractual remuneration terms.