

Employment – 20:20 vision

Providing clarity and insight on employment law matters

Salary and bonus waivers: tax pitfalls and practical issues for the unwary



This briefing considers the voluntary waiver of salary and bonus payments by directors and employees and summarises some of the potential tax pitfalls and practical issues required to give effect to such arrangements.

As the economic effects of Covid-19 continue and companies across all sectors and markets look to manage cash flow, several company directors and senior management have shown solidarity with the workforce by voluntarily agreeing to salary reductions or waiving all or part of their annual bonuses.

You may be forgiven for thinking that such actions should not give rise to financial 'penalties' on those giving up their pay; however, care must be taken when structuring these arrangements as individuals may otherwise find themselves paying tax and NICs, even on the amounts they have given up.

When is remuneration treated as "received"?

Remuneration will normally become taxable when it is "received" for tax purposes. The timing of when individuals waive their remuneration will therefore be critical. If the remuneration is waived after it is received for tax purposes, the individual will remain taxable on that amount (under PAYE) even if the remuneration is not actually paid.

What do we mean by "received"?

Different rules apply to directors and employees, so it is important that you identify which set of rules an individual will fall under.

For employees, who are not also directors, remuneration will be treated as received at the earlier of:

- the time when the payment is made; and
- the time when the employee becomes entitled to be paid.

Directors (whether receiving salaries, fees, bonuses or other remuneration for their role) will likely be treated as receiving their remuneration earlier. For example, when a discretionary bonus is determined rather than when it is paid.

When is salary received?

Whilst salaries are earned on a day to day basis, employees are typically entitled to receive their salaries on their contractual payment dates which will be when the tax charge arises.

This means that an employee should not waive salary after the contractual payment date. For example, if an employee's contractual payment date is the 28th of each month, any agreement to waive any part of the current month's salary should be made by the 27th.

When are discretionary bonuses received?

The point at which employees can waive discretionary bonuses, without incurring tax charges, will likely differ from that of directors.

This is because employees are typically entitled to receive and be taxed on their discretionary bonuses on the dates that they are actually paid. As with salaries, discretionary bonuses are therefore received on the relevant payment dates. For directors, on the other hand, bonuses will often be determined some time in advance of payment. Here, the date of determination will be the date on which the tax charge arises.

When are contractual bonuses received?

Contractual bonuses may (depending on how they are calculated) be determined by reference to a period, such as a company's financial year. A detailed analysis of the terms of the bonus arrangement will always be required. For directors the bonus should be waived before the beginning of the relevant bonus year.

What if an employee or director wants to waive salary or bonus after it is received?

For the reasons outlined above, an employee or director cannot waive salary or bonus after it has been received for tax purposes without incurring a charge to income tax and NICs.

In these circumstances, if an employee or director still wishes to proceed and voluntarily waive salary or a bonus an alternative route might be to suggest that they make a charitable donation. We are aware that directors of a number of listed companies have been reported as making such charitable donations since the beginning of the Covid-19 crisis. It is likely to have been the case that these directors had already received and been taxed on their annual bonuses for 2019 but, to demonstrate that they want to do the right thing, they have gifted their bonus to charities supporting the likes of the NHS.

What should employers be doing?

Whilst determining the point at which employees and directors should waive their remuneration is clearly key, employers must also document these arrangements. This is not only to avoid the tax issues covered above, but so it is clear on what basis the individuals are waiving their entitlement and when this arrangement will end.

- Employers should communicate the rationale for the reductions clearly to employees, in group meetings, or individually as appropriate. In the current circumstances there should be more understanding of the difficult economic challenges faced by businesses and a willingness to consider alternatives (e.g. pay reductions) to avoid redundancies.
- Written variation letters or documents should be prepared in advance of the relevant payment dates and signed by both parties.
- The terms of the variation should be set out clearly, including the rationale for the reduction, when the variation will commence, how long the reduction will last and (if possible) the circumstances in which either the previous remuneration will be reinstated or any new variation will take place or an indication when it will be reconsidered.
- The impact of the pay reduction on pensions, benefits, incentive arrangements and paid absences (e.g. sick pay and maternity pay) should also be explained. If a redundancy consultation is ongoing then the impact of the pay reduction on any redundancy pay, holiday pay and notice pay should also be clarified.
- It will be difficult, but not impossible, for an employer to rely on implied consent for a reduction in remuneration in the current circumstances. All efforts, however, must be exhausted in seeking written consent, which can include agreement by email. If agreement cannot be reached employers can consider dismissing employees and offering to reengage them on the varied terms, however this approach can be risky.
- Collective consultation, with trade unions or employee representatives, may be required if at least 20 employees are affected and may be dismissed if agreement is not reached. Directors must make sure a form HR1 is filed with BEIS within the relevant time limits.
- If employees or directors are being furloughed instead of continuing to work for reduced pay, then additional considerations will apply to ensure compliance with the Government's Coronavirus Job Retention Scheme.

We can advise clients on the issues covered above and assist them in preparing the necessary documents to validly vary directors' and employees' remuneration.

For more information, please do get in touch with your usual Stephenson Harwood contact.

We have a dedicated Covid-19 team of employment lawyers keeping up to date on the latest developments and who are available to answer any questions you may have. You can find more information [here](#).



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