Salary advances: what are the risks for employers?

Salary advances are becoming more commonplace as the cost-of-living crisis bites. Susan Ball and Joe Pickering explain what they are and what factors an employer must consider

Salary advance schemes are arrangements made between an employer and its employees, allowing those employees to access some of their earned salary before their normal pay day.

Third party salary advance schemes are a type of financial product. Using the services of a salary advance provider, an employer provides participating employees with access to part of their salary as it is earned, rather than paying their full net salary on the normal pay day. These arrangements are becoming increasingly popular as employers look to support their employees through the current cost-of-living crisis.

If an employer has signed up with a provider that offers such a service, its employees will be provided with access to an online app or platform where they can keep track of what they are earning. The employer decides what percentage of an employee's salary can be made available to them as an advance, and the employee can see what amount is accessible to them.

The salary advance provider will usually charge a fee to the employee per withdrawal, and a fee to the employer for the platform. Any salary advanced, and any fees borne by the employee, will be deducted from the net pay the employee subsequently receives on the normal pay day.

These schemes may be perceived to have a number of risks, such as the opaque nature of charges that make it difficult for the employee to understand the true cost compared to other forms of credit, a lack of regulation, and the potential for dependency and repeat use by some employees.

What are the tax implications?

Typically, many current salary advance schemes operate on the basis that the arrangement does not affect the employee's income tax or National Insurance contributions (NICs) position, and that the employee's regular earnings are reported through payroll on the normal basis, with an adjustment for any salary advances deducted from the employee's net pay.

However, for payroll purposes, where there is an advance of salary or wages, strictly this is reportable and subject to income tax and NICs through the PAYE system on or before the time the payment is made.

Whilst there is an easement for 'ad hoc' payments made outside the normal payroll run, it is unlikely that a formalised salary advance scheme would fall within this easement. In fact, in its November 2022 Agent Update Issue 102, HMRC recognised that the statutory position, if applied to salary advances, creates extra administrative burdens for both employers and HMRC because of the requirement to submit additional real time information (RTI) payroll returns, and that these additional returns may also impact on HMRC processes, creating risks such as PAYE coding or universal credit errors.

Expected new easement

To address these issues, HMRC has confirmed that amendments will be made to the PAYE legislation, so that salary advances can be reported on or before the employee's contractual pay day. This means each payment of salary only needs to be included on an RTI report once. Nevertheless, reporting is still required and employers not reporting on time may run into issues with HMRC, including the possible imposition of interest on late payment of tax and penalties. However, HMRC states that employers that are currently reporting salary advances on or before employees' contractual pay date may continue to do so until the new legislation is in place.

Further information, including plans to update HMRC guidance, will appear in a future edition of HMRC's Employer Bulletin. That said, depending on the nature of the agreement in place between an employer and its employees, salary advances could be considered to be loans, which may not impact the RTI reporting but may instead have other tax and legal consequences. Provided the aggregate of all loans made to an individual employee does not exceed £10,000, genuine loan arrangements are not reportable by the employer or taxable on the employee.

However, the provision of loans (particularly where a third party is involved) may be an activity regulated by the Financial Conduct Authority (FCA) and carry separate complications. If the total aggregate loans to an employee exceed £10,000 in a particular tax year, a taxable benefit and form P11D reporting requirement will arise.

What do employers need to consider?

There are a number of points for employers to consider:

- Has the arrangement been reviewed to identify if it is in fact the provision of a salary advance or a loan, and is this review appropriately documented?
- Is a payroll submission, and income tax and NICs withholding, required at the time of payment?
- Does the arrangement create a taxable beneficial loan for the employee, and is P11D reporting required?
- Does the arrangement impact the employee's universal credit position (which is typically based on the employee's net pay in the monthly assessment period)?
- Will repayments, in particular of service or other fees, potentially reduce the employee's earnings to an amount below the national minimum wage or national living wage?
- Does the scheme fall within the criteria for FCA regulation?
- Do employees fully understand the scheme, and is there transparency around the associated costs?
- Repeated use of these schemes may potentially exacerbate debt issues and can cause employees to become reliant on them. Is there other support that can be provided alongside to help employees with debt issues?
- Could the scheme create reputational risks for the business?
- Would it be better to change the employees pay frequency?

• Susan Ball, Partner, RSM. Email Susan.Ball@rsmuk.com. Joe Pickering, Associate Director, Employer Solutions, RSM. Email Joe.Pickering@rsmuk.com