July 2012

Updated guidance on implementing the Cycle to Work Scheme

This update on the cycle to work scheme complements the existing implementation guidance on the Department for Transport website in regard to the scheme.

The following document is for guidance only and reflects the tax position at the time of writing. It seeks to provide clarification of the recent changes to the scheme. It will also provide details of the continued benefits of participating and operating the scheme. The following areas are explained below:

1. End of hire agreements – fair market value
2. Change to the treatment of VAT

About the cycle to work scheme

Introduced in the 1999 Finance Act, the cycle to work scheme is a tax-exempt employee benefit, operated predominantly through the salary sacrifice mechanism, which provides an affordable and cost-efficient way to encourage individuals to take-up cycling. The scheme encourages employers to loan bicycles and cycling safety equipment to employees for the purposes of cycling to, from and at work.

At the end of the loan period the employer may choose to give the employee the option to purchase the equipment. Participants in the scheme save income tax and National Insurance contributions on the cost of hiring a bicycle from their employer, saving between 32% and 42% on the overall cost, depending on the personal tax circumstances.

> ***Case Study – A newly implemented scheme***
> An employer offering the cycle to work scheme saw over 20% of the workforce participating within just one year.
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> Helping employees improve their fitness has been the key decision in the company choosing to offer the scheme. Many employees within the organisation face annual fitness tests and staff believe their participation in the scheme is an excellent way for them to prepare for this and, as such, is highly valued by employees. In addition, the organisation believes that offering the scheme provides a way to help their employees living in remote areas commute to and from work.
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> For this employer, their provider has incorporated recent changes to the scheme, namely the introduction of the Fair Market Value (FMV) matrix and the treatment of VAT, to help encourage employees to take up the scheme. The scheme provider has worked with the employer to determine the most appropriate end of hire solution in this situation.

1. End of hire agreements – fair market value

On the 6th August 2010, HMRC issued new guidance clarifying the end of loan arrangement between employers and employees who wish to buy the bicycle.

HMRC introduced a ‘fair market value’ matrix to provide clarity around the acceptable market value of cycles at the end of the loan period. This is the price an employee must pay, should their employer offer them ownership of the bicycle at the end of the loan period.

Table 1 provides a breakdown of how employers can accurately calculate the correct value at the time ownership of the bicycle is offered to be transferred to the employee. It is only at this point where the market valuation percentage becomes relevant.

Table 1 – Fair Market Value matrix

Age of cycle	Acceptable disposal value as a percentage of original price (including VAT)	
	Original price of the cycle less than £500	Original price £500+
1 year	18%	25%
18 months	16%	21%
2 years	13%	17%
3 years	8%	12%
4 years	3%	7%
5 years	Negligible	2%
6 years & over	Negligible	Negligible

*VAT is included in the valuation percentages

Does this impact the savings generated through the scheme?

No. The savings available through the scheme have remained unchanged as a result of the introduction of the fair market value matrix. Individuals who participate in the scheme are able to save both income tax and National Insurance Contributions on the cost of the bicycle.

As such, the cycle to work scheme continues to generate typical savings, between 32% and 42% for participants on the cost of a bicycle and cyclist safety equipment.

Individual providers of the scheme work with employers and employees to navigate the fair market value matrix, ensuring that there is minimal administration involved whilst signposting the current savings available to participants.

Case Study – Fair Market Value matrix

For the last four years, the cycle to work scheme has been central to one large local government organisation's retention and recruitment strategy. The scheme has also formed part of the employers drive to improve the health of their employees and contributed to their efforts to reduce their carbon footprint. Since the employer introduced the scheme, it has been used by over 1,000 staff and is widely viewed among the organisation as an extremely popular and valued employee benefit.

During the introduction of the Fair Market Value matrix, the provider running the scheme for this employer ensured that all the changes were fully communicated and that the necessary processes were put in place to fully comply with the matrix's introduction. This helped to overcome any uncertainty staff members may have had regarding the scheme and ensured the scheme was seen as a cost-effective way of taking up cycling.

Since the Fair Market Value matrix was introduced, the provider has continued to help the employer navigate the end of hire agreement. They have taken over any administration involved in running the scheme and ensuring that the organisation is fully compliant.

2. Changes to the treatment of VAT

On the 28th July 2011 HMRC announced changes to the treatment of certain supplies made by employers under salary sacrifice arrangements. This follows a ruling from the Court of Justice of the European Union (CJEU) regarding Astra Zeneca's employee benefits packages. The case before the CJEU found where an employee sacrifices salary in return for retail vouchers then the amount of salary foregone by an employee was payment for VAT purposes. Accordingly, Astra Zeneca was

required to account for VAT on all supplies of retail vouchers made in return for salary sacrificed by its employees.
Although this case was concerned with the supply of retail vouchers to employees, HMRC ruled that theVAT principles surrounding salary sacrifice are of general application and apply to other supplies of goods and services to employees, including the cycle to work scheme.

What is the impact of this on the scheme?
Employers must now account for VAT on the supply of bikes to employees made through the scheme. Participants signing up to schemes after the 28th July 2011 will have these VAT changes built into their salary sacrifice payments by their provider. As a result of these changes, all VAT registered employers can now claim back VAT on the initial cost of the cycles as these costs are directly attributable to the VAT-able supply of leasing the bikes.

It is important to note that the applicability of VAT does not mean a blanket reduction in scheme savings of 20%. For those fully VAT registered organisations, the impact of savings will not apply at 20% of the purchase value of the bike as this will be offset by an increase in income tax and National Insurance Contributions' savings, which continue to apply.

Individual providers have worked with employers to ensure that the scheme continues to provide a viable and cost-effective way of increasing access to affordable bicycles for their employees commuting needs. As a result, employees participating in the scheme remain able to make savings between 32% and 42% on the cost of the bicycle, depending on their personal tax circumstances.

On the 3rd October 2011, HMRC issued a further Brief, detailing that the VAT changes would be introduced via an established process known as grandfathering and, as such, the VAT changes do not apply to Hire Agreements that were signed prior to the 27th July 2011 but which extend beyond 31st December 2011.

Case study
For one national high-street retailer, the cycle to work scheme is seen as an integral part of the company's employee benefits package, whilst helping the business achieve their environmental social responsibility aims.

Since it was first offered by the company in 2010, the scheme has proved hugely attractive to employees. Following the decision to introduce changes to the treatment of VAT, the retailer did find that both employees, and their HR team, were more cautious about the scheme. However, given the positive feedback that the employer received from staff who had previously participated, they were keen to work with their provider to ensure that they could continue to offer the scheme.

As soon as the changes to the treatment of VAT were introduced, the scheme provider made both the employer and all staff aware of these changes and the impact they would have on the operation of the scheme. Since the introduction of the changes, the provider has worked with the retailer to attempt to alleviate any loss of savings and continues to work to ensure the scheme remains viable to individual employees.

Since the changes to the treatment of VAT, the provider has worked with the retailer to account for the changes within the salary sacrifice payment, making the scheme easy for the employer and employee to continue operating their scheme as normal.