For employer use only

A guide for employers

Salary sacrifice and pensions

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Salary sacrifice (also known as salary exchange, SMART Pensions and Smart Pay) can help you provide some of your employees with the opportunity to increase their pension contributions.

What is salary sacrifice?

Salary sacrifice is an arrangement between you and your employees which enables them to boost their existing pension contributions. It can also be used for both of you to save money. Your employee agrees to a reduction in their salary or bonus under their contract of employment with you, and in return they receive the benefit of you paying the equivalent amount into their pension.

Terms and conditions of employment will have to be varied as your employees are giving up their contractual right to the future cash remuneration of the amount sacrificed.

Why use salary sacrifice?

Salary sacrifice can be useful in the following ways:

- You and your employees can both make a saving in national insurance contributions (NICs). You'll save 13.8% of the amount sacrificed in NICs, while your employees will save between 2% and 12% of the amount they sacrifice, depending upon their earnings.
- Salary sacrifice can be used to boost pension savings for your employees while leaving their net spendable income unchanged. It can also be used to maintain the level of pension contribution and increase pay.

How salary sacrifice can work for you

The contribution you make into an employee's pension is not liable for tax or NIC and it does not cost you anything extra. In fact, you'll be making a saving on national insurance (NI) which can be paid into your employee's pension to further boost their pension if you choose. The example on page 2 illustrates in more detail how this can work for basic and higher rate taxpayers.

Advantages of salary sacrifice

- You're able to offer an improved benefits package for your employees.
- You can deduct pension contributions from your tax bill in the same way as salary payments.
- NIC savings for you, if you choose not to pay them into your employees' pension scheme.
- NIC savings for your employees allowing them to pay more into their pension or increase their take home pay.
- The 2016 Autumn Statement announced changes to salary sacrifice for many benefits, resulting in an erosion of the tax and NIC benefits. Pensions salary sacrifice is not included in those changes so remains tax and NIC efficient.

The information contained in this guide is based on Aviva's interpretation of current and proposed legislation as at April 2023. Tax rules depend on the main place of residence as advised to us by HMRC and other individual circumstances of the employee and are subject to change in future.

Important information

- In the case of a basic rate tax payer, this example assumes that the individual is earning less than the Upper Earnings Limit. In the case of the higher rate tax payer, it is assumed that the employee is earning above the Upper Earnings Limit.
- This information is based on our interpretation of current legislation, taxation law and HM Revenue & Customs (HMRC) practice which may change in the future. The value of tax relief depends on the financial circumstances of the employee.
- Calculations are based on 2023/24 tax rates and allowances but aren't appropriate for Scottish tax payers.
- Calculations assume any employee contributions are increased by basic rate tax relief within the scheme through tax relief at source.
- Calculations assume net pay is to remain the same after the salary sacrifice.
- Salary Sacrifice must not reduce gross pay below the national minimum wage.
- The examples assume that the employer passes on all of their NIC savings to the employees' pension.

	Basic rate tax payer
Personal contributions	Employee's net monthly pension contribution is £100
	Employee's contribution is increased by tax relief of £25
	The total invested is £125
Salary sacrifice	Employee agrees to reduce monthly pay before deductions by £147.06*
	Employer pays into employee's pension salary reduction of £147.06
	Employer can pay their NIC saving of up to £20.29 into the employee's pension***
	The total invested is £167.35
	Employee's net income remains the same
	Employee's monthly pension investment increases by £42.35

	Higher rate tax payer
Personal contributions	Employee's net monthly pension contribution is £100
	Employee's contribution is increased by tax relief of £25
	The total invested is £125
	Employee can claim through tax return additional tax relief of £25
Salary sacrifice	Employee agrees to reduce monthly pay before deductions by £129.31**
	Employer pays into employee's pension salary reduction of £129.31
	Employer can pay their NIC saving of up to £17.84 into the employee's pension***
	The total invested is £147.15
	Employee's net income remains the same
	Employee's monthly pension investment increases by £22.15

* **Gross £147.06 less income tax (20%) £29.41, NIC saving (12%) £17.65. Net cost £100.**

** **Gross £129.31 less income tax (40%) £51.72, NIC saving (2%) £2.59. Net cost £75.**

*** **The employer will decide how much of their NI saving will go into the employee's pension. The maximum amount is 13.8% of the reduction in salary. These calculations assume the employer contributes the maximum amount of their NI saving into the employee's pension.**

Please note these are sample calculations only and employee savings will depend on how much they agree to reduce their monthly pay by and how much of the employer's NI saving the company decides to pay into the employee's pension. The calculations also assume that the employee's net income is the same before and after the salary sacrifice.

Things to be aware of about salary sacrifice

It is important to be aware that salary sacrifice may not be suitable for all your employees and to be conscious of the drawbacks.

Salary sacrifice could affect an individual's current or future entitlement to a range of state benefits, including the receipt of tax credits.

If any of your employees' earnings fall below the lower earnings limit, they won't be eligible for:

- statutory sick pay;
- statutory maternity, paternity or adoption pay;
- incapacity benefit;
- jobseeker's allowance (although means-tested benefits may still be claimed).

If an employee's salary falls below the lower earnings limit (£6,396 per annum for the 2023/24 tax year) their entitlement to State pension benefits will be affected.

Salary sacrifice should not reduce your employees' cash pay to below the national minimum wage. This means care needs to be taken when including those working full-time and earning around £14,000 a year or less in any salary sacrifice scheme.

Other possible impacts on your employees are on borrowing levels, such as mortgage borrowing, credit card and personal loan limits, income protection insurance benefits and redundancy entitlements.

The value of the pension pot is not guaranteed and can go up and down depending on investment performance. Your employee's could get back less than they've paid in.

How is salary sacrifice arranged?

In order for you to ensure you meet the rules laid down by HM Revenue & Customs (HMRC) for salary sacrifice, the following factors need to be met:

- You must revise the terms and conditions of employment between you and your employee.
- This revised contract must state that your employee is entitled to a lower cash remuneration and a benefit as a result of a sacrifice.
- The agreement between you and your employee must refer to the benefit being given in exchange for the sacrifice.
- Only future remuneration can be sacrificed by your employee, this means that it must not be money 'received' by employees for tax and NIC purposes.
- HMRC don't require salary sacrifice to be reported but it is prudent for employers to keep copies of the revised contract in case it is required.

Draft agreement

An example of specimen wording between employer and employee which may constitute a valid salary sacrifice:

Today's date

Dear ....

This is to inform you that, with effect from [insert effective date], your contractual right to salary will be reduced from £22,000 a year to £20,235 a year, in return for the company making a £1,765 a year employer's contribution in to the xyz pension scheme for your benefit.

[We'll also make a contribution representing our national insurance saving.]

This letter constitutes a change to your contract of employment.

Yours sincerely

...

For the Company

I agree that my salary should be contractually reduced as described above.

Signed ....

Dated

Bonus sacrifice

Your employees can sacrifice bonus for a non-cash benefit, such as pension contributions, in the same way they can sacrifice their salary. In return they can receive the benefit of you paying the bonus into their pension. This is called bonus sacrifice or exchange.

Things to be aware of about bonus sacrifice

- The bonus must be sacrificed before it is treated as received. Remuneration is treated as received when the payment is actually made or, if earlier, when the employee is entitled to receive it. For example, an employee may be entitled to a payment on 1 October 2021, but actual payment may not be made until 12 February 2022. The employee is deemed to receive it on 1 October. Please note there are additional earnings rules for directors that you'll need to take account of when managing bonus sacrifice for them. These are set out here: **gov.uk/hmrc-internal-manuals/employment-income-manual/eim42260**
- The employee cannot change their mind once they have agreed to sacrifice the bonus.
- Bonus sacrifice can also affect your employee's entitlement to state benefits.
- Please note the timings illustrated below with regard to bonus sacrifice.

Example bonus sacrifice of £10,000

An employee is contractually entitled to a bonus depending on the level of the employer's profits each year.

The company year end is 31 January.
The company's accounts are finalised on 31 July enabling the amount of bonus entitlement to be calculated.

You notify the employee by letter of a £10,000 bonus payment due in October's payroll (01/10/2023). The letter states that the employee can choose to receive the bonus or give up their contractual rights to all or part of the bonus in return for the company making an employer's payment of £10,000 plus any NIC saving they decide to give up to the pension scheme.

The employee chooses to sacrifice all of the bonus payment in exchange for a £10,000 employer pension payment.

The bonus must be sacrificed by September (30/09/2023), so the employee must make sure they return the completed documentation by that date.

This is a successful sacrifice as the employee has given up their contractual right to the bonus before it is treated as received.

If your employee is a higher rate taxpayer

If the employee takes cash	If the employee takes the bonus as a pension payment
The employee pays £4,000 income tax	You pay £10,000 into the employee's pension
The employee pays £200 NI	You can pay your NI saving of up to £1,380 into their pension*
The employee receives a net bonus of £5,800	**The employee's total pension investment is up to £11,380**

* You decide how much of your saving will go into their pension. The maximum amount is 13.8% of the bonus. These calculations assume that you contribute the maximum amount of your NI saving into your employee's pension.

Things to be aware of when setting up salary sacrifice

Specialist employment advice

Salary sacrifice affects the employee's contract of employment and is a matter of employment law not tax or pension law. You should take specialist employment advice on how best to vary the employment contract.

Employer NIC savings

It's up to you to decide whether to rebate some of your NIC saving back into your employees' pension scheme.

Informing HMRC

There is no obligation on you to inform HMRC that salary sacrifice has been set up. However, many employers will do so for reassurance that they are calculating the correct amount of income tax and NI. Additional information is available on the HMRC website at **hmrc.gov.uk**

'Opt in' or 'opt out'

You can set up the scheme so that employees can either 'opt in' or 'opt out' of salary sacrifice. Depending on which option you choose, you'll need to get your employees' agreement by including it in their contract of employment.

Bonus sacrifice

Bonus sacrifice is not the same as salary sacrifice in that bonuses are not usually a contractual right and it is important to note the timing required for successful bonus sacrifice. You need to agree the terms of bonus sacrifice with the employee and decide if the bonus sacrifice is to be a one off payment or for a number of years before the employee becomes entitles to the bonus, which can be before it's value is known.

Payroll

You'll need to check if your payroll system is able to support a salary sacrifice scheme, particularly if you're going to base other benefits on employees' notional salary before the sacrifice.

Communication to employees

Once you've set up a salary sacrifice scheme, you'll need to ensure that your employees understand all the implications. You may wish to consider a mix of forums, workshops and communication, such as personal letters, flyers or posters, to explain the advantages and disadvantages of the possible tax and NI savings, and how it impacts other benefits.

Questions and answers

How often can employees 'opt in' and 'opt out'?

HMRC no longer require employees to sign up to salary sacrifice for pension benefits for a fixed period of time. The employee's terms and conditions will need to be changed in a way that is legally enforceable each time they 'opt in' or 'opt out'. You'll need to know what each employee is entitled to at any given time in order to make the correct tax and NIC payments.

How long do employees have to sign up to the scheme for?

HMRC no longer specify a minimum period for which employees must agree to salary sacrifice.

Where the scheme is being used as a qualifying scheme for automatic enrolment, salary sacrifice cannot be a condition of becoming a member of the scheme or of maintaining membership, so employees must be able to "opt out" of salary sacrifice, but maintain membership of the pension scheme, whenever they want.

When can an employee change their existing terms and conditions?

This is for you to decide. If your scheme is a qualifying pension scheme you'll need to allow employees to opt out of salary sacrifice at any time. For non qualifying schemes you're able to set your own rules around when employees are able to alter their salary sacrifice arrangements with you. HMRC no longer restrict changes to life events.

What is the significance if salary sacrifice appears as a deduction against the old salary on an employee's payslip?

Payslip information may not be considered important where the employment contract has been effectively varied. However, in circumstances where changes to the employment contract have not been made or are ambiguous, HMRC will base a decision about the earnings an individual is entitled to on available information, this may include payslips. The payslip will need to show the post salary sacrifice pay as gross pay.

Can salary sacrifice take pay below the national minimum wage?

At any time during employment an employee's gross pay must not fall below the national minimum wage or national living wage rates, either before or after the salary sacrifice reduction. The rates from April 2023 are:

- £7.49 for those aged 18-20

- £10.18 for those aged 21-22

- £10.42 for those 23 and over.

This is particularly important to note when employees are paid an hourly wage as it is difficult to make a salary sacrifice arrangement that provides the same net income both before and after the sacrifice. This is because the amount payable will fluctuate depending on the number of hours worked.

There is a minimum wage calculator available at **gov.uk/am-i-getting-minimum-wage**

What is the impact on salary related payments?

Salary related payments such as overtime rates, pay rises, statutory maternity pay (SMP) and statutory sick pay (SSP) can be affected by salary sacrifice. You may wish to continue to base contributions on the original higher (notional) salary or the new lower salary post sacrifice. Care should be taken to ensure that you don't breach employment law and equalisation rights in respect of SMP.

Employees need to understand how salary sacrifice may affect other salary related payments.

How does salary sacrifice affect corporation tax?

In salary sacrifice situations the normal rules relating to the spreading of corporation tax relief on pension contributions apply.

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How to contact us?

0345 602 9221

ngp.questions@dgaviva.com

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