

The Benefits of Salary Sacrifice

A guide to Employers

There is now little distinction between National Insurance Contributions and income tax. The Chancellor has recognised this and will soon start consultation over the merging of NICs and income tax.

One consequence of the increase in NICs which currently total up to 25.8% of earnings has been the growth in the use of salary sacrifice arrangements. Salary sacrifice is designed to save NICs and potentially boost pension contributions.

By way of example for a basic rate taxpayer with contracted-in earnings below the upper earnings limit (£42,484 in 20011/12) salary sacrifice can produce over 33% more input into a pension than through personal contributions, if the employer invests their full NIC saving.

Salary sacrifice in practice

A salary sacrifice involves the pension scheme member accepting a lower salary 'in exchange' for the employer making extra pension contributions on their behalf. The employer (and the employee) will save NICs on the salary forgone and this is usually the reason for choosing salary sacrifice over personal contributions. The employer's NIC savings are 13.8% of the salary sacrificed. Some employers choose to recycle a proportion of that back into the employee's pension. A margin is normally retained to cover administrative costs.

Many large employers, such as BT and Tesco, integrate salary sacrifice into their main pension schemes as a way of collecting employee contributions. Similar arrangements may apply for voluntary top-up contributions.

Salary sacrifice is usually offered as an option, because for some employees it may not be beneficial to reduce their salary.

- The salary reduction is usually documented by an exchange of letters between employer and employee which detail a reduction in cash remuneration in exchange for additional pension provision.



- Bonus sacrifice, where the employee sacrifices some or all of a bonus. The same principles apply as with salary sacrifice. To be effective, any sacrifice must be agreed and documented before the salary or bonus is treated as being received for income tax purposes.

Drawbacks of salary sacrifice

There are a number of potential drawbacks that come from the use of salary sacrifice:

- Salary is reduced for all purposes. Where the sacrifice is offered as an integral part of the employer's pensions scheme, there could be an actual reduction in benefits, e.g. lower death-in-service life cover.
- The salary reduction will have a real impact on reducing or even possibly eliminating S2P accrual for employees who are not contracted out, where the sacrifice relates to earnings below the UAP.
- The reduced pay may also mean a loss of other social security benefits, but usually the problem only arises when the resultant salary is below the earnings limit (£102.00 a week in 2011/12) which triggers benefit entitlement. At higher levels there may be a small loss, e.g. for the first six weeks of statutory maternity leave, which is based on average earnings
- The reduced pay may reduce mortgage borrowing capacity.
- Salary sacrifice will not be possible if the result is to bring pay rates below the national minimum wage

HMRC view of salary sacrifice

Her majesty's Revenue & Customs (HMRC) will not give advance clearance for salary sacrifice schemes. HMRC has to be satisfied that the salary sacrifice is effective once it is in place. HMRC says that the effect of the contractual change must be that the employee has given up the right to some of their cash pay in return for the benefit.

