PK | EMPLOYEE BENEFITS

EMPLOYEE'S GUIDE TO SALARY SACRIFICE

What Is Salary Sacrifice?

Salary Sacrifice is an arrangement whereby an employee agrees to reduce their earnings in exchange for their employer paying an equivalent amount directly into their pension as an employer payment.

All pension contribution methods benefit from Income Tax relief however using Salary Sacrifice means that the employee saves National Insurance Contributions (NICs) on the amount sacrificed as well.

It also has the additional advantage in that no Higher or Additional Rate Income Tax relief need be claimed from HMRC as all employee Income Tax savings are made immediately.

Essentially, as you are no longer receiving this money as income, it is no longer subject to Income Tax or NICs. The money is added to your employer’s normal pension contribution and paid into your pension as a tax-free amount.

The employee’s contract of employment is amended to reflect the fact that they have agreed to sacrifice part of their future salary or bonus in exchange for an enhanced employer pension contribution. This may be achieved through a simple exchange of letters.

To ensure compliance with HMRC rules on Salary Sacrifice, your employer may place a limit on how many times you can make changes to the way in which you pay pension contributions.

Benefits to Employees

The primary saving is for those whose total earnings fall below the Higher Rate Income Tax threshold (£50,270 per annum in 2024/25). Employee NICs at this level are 8% and so this makes a significant difference to the tax efficiency of pensions as this represents an increase of nearly 50% relative to those just receiving tax relief at the Basic Rate of 20%

Those with earnings above this threshold only receive 2% NIC savings however they will immediately receive all of their Higher and Additional Rate Income Tax savings rather than having to claim this from HMRC.

The practical effect of this should not be underestimated – although, in theory those earning over the Higher Rate threshold qualify for extra tax relief, many do not claim it and many do not realise that HMRC have to be constantly updated if they are to receive their full entitlement.

It should be noted that, for employees over State Pension Age, employee NI is no longer payable and so such employees would not save NI by using Salary Sacrifice.

Let’s look at examples of the net cost to employees of pension contributions under both methods.

Deduction from Net Pay - £100 per month gross personal contribution

When payments are deducted from Net Pay, the pension provider automatically adds Basic Rate tax relief – so, an £80 net deduction from pay becomes a total contribution of £100 to the pension (Basic Rate tax currently being 20%)

Tax Rate	Deduction from net pay	Extra tax relief to be claimed	Total net cost to employee	Total contribution invested
Basic (income less than £50,270 per yr)	£80	NIL	£80	£100
Higher (Income between £50,270 and £125,140)	£80	£20	£60	£100
Additional (Income over £125,140)	£80	£25	£55	£100

Salary Sacrifice - £100 per month gross personal contribution

Tax Rate	Deduction from gross pay	Savings in tax + NI	Effective net cost to employee	Total contribution invested
Basic (income less than £50,270 per yr)	£100	£20 + £8	£72	£100
Higher (Income between £50,270 and £125,140)	£100	£40 + £2	£58	£100
Additional (Income over £125,140)	£100	£45 + £2	£53	£100

NB: Tax rates and thresholds differ in Scotland.

Considerations – Employee Benefits

Some employee benefits are salary related – the two most obvious being Group Life Insurance and Group Income Protection Insurance. Employers typically also base pay rises, bonuses, redundancy and other payments on the level of an employee's Basic Salary.

In order to avoid creating a disincentive to employees to invest, your employer will use a 'reference salary' – that is a record of what the employee's Basic Salary would have been had they not opted to engage in Salary Sacrifice. All such benefits will then be based upon this reference salary rather than the employee's reduced, post-Salary Sacrifice salary.

State Benefits

Some State Benefits, such as Tax Credits, Universal Credit and Statutory Maternity and Sickness pay are affected by an individual's income.

Salary Sacrifice, because it reduces an individual's income, may increase entitlement to Universal and Tax Credits.

However, employees should be aware that, to qualify for SMP and SSP there is a minimum income requirement of £123 per week in the 2024/25 Tax Year and they may wish to re-consider Salary Sacrifice if it would take their income below this level.

For most employees, this should not be a problem as National Minimum Wage (NMW)/National Living Wage (NLW) legislation is also a consideration as employees may not use Salary Sacrifice to reduce their Gross Income below these levels.

Maternity Pay

How individuals are affected by Salary Sacrifice will depend very much upon their employer's own Maternity Pay rules, however one general principle to be aware of is:

- Calculation of Average Weekly earnings (AWE) – as the employee has reduced their income, then the income that is used for the AWE calculation will be less than prior to using Salary Sacrifice

The minimum legislative requirement for Maternity Pay is that employers must pay 90% of AWE for 6 weeks then SMP thereafter. However, many employers will offer enhanced Maternity Pay and individuals who think that they may be affected should ensure that they fully understand their own employer's rules.

Child Benefit

If an individual or their partner earn over £60,000 per year then they are affected by the 'High Income Child Benefit Tax Charge': https://www.gov.uk/government/publications/income-tax-increasing-the-high-income-child-benefit-charge-threshold

Simply put, this means that they either have to forgo some, or all, of the Child Benefit or pay tax on it.

Depending upon the level of income, it may be possible to use Salary Sacrifice pension contributions to reduce income sufficiently (i.e. to below £60,000) to 'reclaim' this benefit.

In the same way, Salary Sacrifice may be used to reduce income below other benefits or taxation thresholds.

Tax and NIC thresholds

In the 2024/25 Tax Year, the threshold for paying Income Tax is £12,570 per annum. Employees whose income falls below this level would not make tax savings using Salary Sacrifice as their wages would not have been taxed in the first place.

Such employees will, however, still get Tax Relief at the Basic Rate added automatically to their pension contributions if they pay by deduction from Net Pay.

If an employee's income falls below the Lower Earnings Limit (£123 pw in the 2024/25 Tax Year) they will not be accruing State Pension Benefits.

Mortgages/Loans

Generally speaking, the lower an individual's pay, the less they can borrow on a mortgage or other loan. Mortgage lenders have quite sophisticated affordability calculations these days which take many factors, not just pension contributions, into account and so we recommend taking advice from an independent mortgage broker for those likely to be applying for a mortgage in the near future.

It may be possible to benefit from 'The best of both worlds' by using Salary Sacrifice now to lessen the cost of pension contributions and then converting back to deduction from net pay in the run up to a mortgage application.

PK Group have Independent Mortgage Advisers available to employees whose employers retain P K Employee Benefits to service their pension scheme.

How to benefit From Salary Sacrifice

The form to convert your contribution payment method to Salary Sacrifice and/or vary your contribution level is available here: Pension Contribution Form

NB – not all employers offer Salary Sacrifice as a pension contribution payment method.

Higher rate taxpayers please note: if you are already claiming Higher Rate Income Tax relief from HMRC please remember to cancel this when you convert your payment method to Salary Sacrifice.

This document is intended for information purposes only and is not intended to provide advice. Levels and bases of taxation will vary dependent upon individual circumstances and are subject to change. PK Group recommend that employers and individuals take specific guidance before taking any action.