First Briefing, January 2019
Salary Exchange

In the current economic climate employers are having to achieve savings in all aspects of their business, whilst also seeking to motivate and retain staff. Utilising "salary exchange" or "salary sacrifice" for pension contributions can produce a win-win situation with both the employer and employee able to achieve savings in National Insurance (NI) contributions.

How does salary exchange work?

Under salary exchange, an employee chooses to reduce their gross salary by an amount equal to their desired pension contribution. In return, the employer agrees to pay an additional amount into the pension scheme, equivalent to the gross amount of salary the employee has exchanged.

Employer and employee NI is payable on gross salary, but is *not* payable on employer pension contributions. Therefore, a salary exchange arrangement will generate NI savings for both the employer and employees, who will see an increase in their take-home pay. The total amount of money being paid into an employee's pension fund remains the same, and their total pension benefits are unaffected. The arrangement is voluntary and is available for use with most pension schemes. It can be operated on either an "opt in" or "opt out" basis.

What National Insurance savings can be made?

Depending on the size of the workforce, together with the level of employee contributions, employer savings from salary exchange can be substantial. The tables below show the employer and employee NI rates for 2018/19:

Annual earnings	Employee	Employer
Up to £8,424	Nil	Nil
£8,424 to £46,350	12.0%	13.8%
Over £46,350	2.0%	13.8%

An example of both employer and employee savings, assuming an employee earns £35,000 a year and pays 5% of their salary (£1,750) into a scheme, is set out below:

	Employee NI	Employer NI
Without salary exchange	(£35,000 - £8,424) x 12% = £3,189	(£35,000 - £8,424) x 13.8% = £3,667
With salary exchange	(£33,250 - £8,424) x 12% = £2,979	(£33,250 - £8,424) x 13.8% = £3,426
Annual saving	**£210**	**£241**

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What do I need to consider when introducing salary exchange?

When establishing a salary exchange arrangement, employers should ensure that sufficient time is allowed for implementation. All interested parties, including HR, Payroll and Finance should be involved to ensure all relevant factors are discussed and a common approach is agreed.

During the planning stage, there are a number of questions employers need to consider, which include:

- Are all staff to be included?
- What method will be used to enrol employees – “opt in” or “opt out”?
- Will a minimum salary level be set for automatic inclusion to ensure National Minimum Wage (NMW) and National Living Wage (NLW) are maintained and State Benefits are not affected?

The key to success when introducing salary exchange is a good communication exercise during the implementation phase. By using member booklets, FAQs and member presentations, employees will have a better understanding of how salary exchange operates and whether participation will be beneficial for them.

Will the Government stop salary exchange?

Salary exchange has been available to employers for over twenty years, although it has only become widespread recently.

In the Autumn Statement of 2016, the Government announced curbs on various salary exchange arrangements from April 2017. However, pension contributions, childcare, ultra-low emission cars and cycle to work schemes were excluded from these changes. This is not to say that salary exchange may not be reviewed again in the future, but for the time being it remains available for pension contributions.

Is salary exchange suitable for everyone?

No. For low earners care is needed to allow for factors such as the NMW, NLW and certain State Benefits, such as Statutory Sick Pay and Statutory Maternity Pay, that are related to gross earnings. In addition, it may not be tax efficient for them to participate in such an arrangement.

As a result, lower paid employees may need to be excluded from salary exchange.

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What are the reporting requirements for salary exchange?

There is no legal requirement for an employer to inform HMRC that a salary exchange arrangement has been set up. HMRC cannot and will not comment on how to set up a salary exchange arrangement, or whether draft documentation will achieve a successful salary exchange. Their only interest is in determining how the tax and NI legislation applies to the various elements of the employee's remuneration package. As such, HMRC will only comment on proposed transactions in a very limited range of circumstances.

Would you like to discuss this bulletin?

Even if you already operate salary exchange we would recommend that your processes and communications are regularly reviewed to ensure they are compliant. Some employers are also considering switching from a voluntary opt-in approach to an opt-out approach in order to maximise the savings available.

If you want to discuss the issues in this bulletin in the context of your organisation, then please contact your usual First Actuarial consultant or any of the First Actuarial DC Team below:

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