

Housing briefing, February 2021

Salary sacrifice

Introducing salary sacrifice for the payment of pension contributions can result in a win-win outcome, with National Insurance savings for both you and your employees.

Salary sacrifice

Salary sacrifice, or salary exchange as it is sometimes known, is an arrangement which allows for employees' pension contributions to be paid more efficiently. And it generates National Insurance savings for both employees and employers.

Salary sacrifice has long been a way of making pension contributions (as well as certain other benefits) more efficient, but there has always been a degree of mistrust over its legitimacy.

However, HMRC is now more accepting of it as a practice, going so far as to provide guidance on how to operate the arrangement (viewing it as a matter of employment law, not tax law). And since April 2017, Government has provided a restricted list of the types of benefit that can be provided through salary sacrifice, and has confirmed that contributions to pension saving will still be permitted.

How salary sacrifice works?

Salary sacrifice for pension contributions involves employees giving up part of their salary. In exchange, their employer makes a pension contribution on their behalf.

Through salary sacrifice, National Insurance contributions (NICs) are paid on the employee's reduced salary. This results in savings for both the employer and the employee. The employee's net take-home pay increases because they're paying lower NICs.

The current thresholds for employee and employer NI rates for 2020/21 are:

Annual earnings	Employee NICs	Employer NICs
Up to £8,788	Nil	Nil
£8,789 to £9,500	Nil	13.8%
£9,501 to £50,000	12%	13.8%
Over £50,000	2%	13.8%

The table below compares the NICs payable with and without salary sacrifice for an example member. The example assumes that the employee earns £25,000, with 5% of their salary (£1,250) paid into a Defined Contribution pension scheme each year.

Salary sacrifice	Employee NICs (each year)	Employer NICs (each year)
Without salary sacrifice	(£25,000 - £9,500) x 12% = £1,860	(£25,000 - £8,788) x 13.8% = £2,237
With salary sacrifice	(£23,750 - £9,500) x 12% = £1,710	(£23,750 - £8,788) x 13.8% = £2,065
Annual savings	£150	£172

From this, we can see that employees receive an increase in their take-home pay, and that at the same time, salary sacrifice results in significant employer National Insurance savings (the exact amount of which will depend on the size of the employer's workforce).

Is salary sacrifice suitable for everyone?

Care needs to be taken as the use of salary sacrifice arrangements may not be appropriate for all employees, especially low earners whose earnings fall below the Lower Earnings Limit (LEL), set at £6,240 p.a. in the 2020/21 tax year.

This is because in cases where participation in salary sacrifice results in zero NICs being payable, certain state benefits can be affected, including:

- New State Pension
- Statutory Sick Pay
- Employment and Support Allowance.

To overcome this problem, most employers make sure that anyone earning less than the LEL is automatically excluded from salary sacrifice arrangements. Employees earning close to the National Minimum Wage or the National Living Wage should also be excluded from salary sacrifice because it is illegal to pay someone less than these amounts.

Because salary sacrifice is not suitable for all employees, any employer planning to introduce salary sacrifice should agree which employees to exclude automatically (and conversely, which employees to include automatically unless they want to opt out) as part of any implementation project.

Note that Local Government Pension Scheme regulations excludes its members from using salary sacrifice.

Communication

Communication is a key aspect of any pension change project and salary sacrifice is no exception. Salary sacrifice is not an easy concept to explain to staff – employees are often instinctively suspicious of the arrangement as it doesn't seem logical that giving up salary will save them money!

It's possible to implement salary sacrifice with a straightforward letter varying the terms of an employee's contract. In our experience, however, the more successful implementations use staff booklets, FAQ documents and staff presentation or webinars to maximise understanding and take-up by employees.

Salary sacrifice modelling

To help you understand the National Insurance savings that salary sacrifice can generate, we can carry out modelling that will demonstrate the benefits of salary sacrifice for your specific pension schemes.

Our modelling can show the total potential employer NI saving for you and provide an indication of the savings available for individual employees.

How First Actuarial can help you

First Actuarial provides independent advice to more housing associations than any other firm. If you would like to discuss pensions with us, then please contact your usual First Actuarial consultant or any of our nationwide housing specialists.

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