



Salary Sacrifice – Save Tax and NICs

Salary sacrifice schemes have been around for some time, yet many companies continue to fight shy of implementing them, despite the potential for substantial savings for employees and employers alike. In this article we explain what salary sacrifice means, what it involves and why, for the vast majority of employees, it can be very beneficial. We also highlight some of the pitfalls and where sacrifices don't work for some employees.

What is salary sacrifice?

A salary sacrifice or salary exchange takes place when an employee gives up the right to part of the cash remuneration (salary) due under the contract of employment. Usually, the sacrifice is made in return for the employer's agreement to provide the employee with some form of non-cash benefit, such as a contribution to a pension scheme.

Why does that save tax and NICs?

Certain non-cash benefits can be provided to employees without attracting tax or National Insurance charges. The primary examples are:

- Pension contributions
- Childcare vouchers
- Bicycles, under cycle-to-work schemes
- Workplace parking

How much are the savings worth?

For basic-rate taxpayers sacrificing salary for pension contributions, the savings in tax and national insurance mean the pension contribution can be increased by a minimum of nearly 16%. If the employer agrees to add their own savings in employer's national insurance, the pension contributions can be increased by nearly 31% in total. The example below shows how this works.

Pension salary sacrifice example

Take an employee making an £80 per month contribution to a pension fund from net pay.

Scenario 1 – No salary sacrifice – basic rate taxpayer The £80 net monthly pension contribution has basic rate tax (at 20%, 2009/10) added to it to achieve a gross pension contribution of £100 per month.

Scenario 2 – Salary sacrifice – basic rate taxpayer The employee sacrifices £115.94 of gross pay per month. This gross pay is worth £80 of net pay to the employee after deductions of basic rate tax (20%) and national insurance (11%). So the employee sees the same reduction in net disposable income of £80.

The employer contributes the sacrificed salary of £115.94 to the employee's pension. The result is that the pension contribution increases by £15.94 or 15.94%. This increase comes because there is no longer any employee national insurance charged on the sacrificed salary.

At the same time, the employer sees a saving of £14.84 in employers national insurance (12.8% of the sacrificed salary). The employer may decide to retain this money, to deploy it elsewhere in providing benefits or to add all or part of it to the pension contribution. Adding all of it to the pension contribution will result in a total pension contribution of £130.78 – a 30.78% uplift compared to the pre-sacrifice position.

For higher rate taxpayers savings can also be significant, although the uplift from saving employees national insurance is more limited because higher rate taxpayers only pay national insurance at 1% on earnings over £43,875 per year (2009/10 levels). However, an ancillary benefit for higher rate taxpayers is that higher rate tax relief on contributions no longer needs to be claimed in the year-end tax return.

Why doesn't it work well for other non-cash benefits?

Other non-cash benefits may save on employee national insurance contributions but are still subject to tax and employer national insurance (Class 1A) contributions through the P11D reporting process. Private medical insurance premiums are a good example. These can be paid by the employer and recovered through salary sacrifice. However, a P11D must be completed for the employee and the cost of the benefit would be taxed. The employee would save on their national insurance contributions, albeit only at the rate of 1% for higher rate taxpayers.

What's HMRC's stance on salary sacrifice schemes?

Because salary sacrifice is an employment law matter, involving a variation in the terms and conditions of employment, HMRC is interested only in determining the consequent tax and NICs liabilities. It does not have a view about whether such arrangements are good or bad for employees in principle.

HMRC will not advise on setting up salary sacrifice schemes, although they will confirm whether the correct tax treatment is being made for arrangements already in place. Accordingly it makes sense for new schemes to be set up on a very limited basis initially in order to obtain HMRC's confirmation, before rolling them out to the wider employee base.

Salary sacrifice Q&As

1. **How long should a sacrifice arrangement be fixed for?** We suggest that sacrifice arrangements should be set for at least a year, given the administration involved in varying employment contracts and to avoid any suggestion that the arrangement is not a permanent change in the terms.
2. **Can employees retain a right to revert to the former salary?** In certain circumstances, and subject to the rules of the scheme, employees can choose to revert without losing the tax and NI savings achieved so far:
 - a. Exempt benefits for which special legislation has been enacted. These are:
 - i. Employer-provided childcare
 - ii. Workplace parking
 - iii. Employer-provided cycles and related safety equipment
 - b. "Lifestyle changes" where unforeseeable events render the sacrifice arrangements inappropriate, such as pregnancy, divorce, marriage, redundancy of partner etc.
3. **Can the employer continue to operate the pre-sacrifice salary for certain purposes?** Yes. Quite often, the pre-sacrifice salary is needed to calculate overtime and bonus payments as well as other salary-related benefits such as group life assurance etc. Most employers therefore also record the pre-sacrifice salary as a "notional" or reference salary.
4. **Are sacrifice arrangements suitable for everybody?** In short, no. Entering a salary sacrifice scheme may affect entitlements to:
 - a. Working Tax Credit (WTC) and Child Tax Credit (CTC)
 - b. State Pension or other benefits such as Statutory Maternity Pay (SMP)

For these reasons, salary sacrifice schemes cannot be mandatory in order for the benefits to be offered. For example, employees should always have the option of joining a company pension scheme regardless of sacrifice decisions.

And finally.....

Salary sacrifice **cannot** reduce an employee's level of pay below the National Minimum Wage – that's an absolute barrier even though the employee might themselves want to sacrifice.

For help with implementing salary sacrifice schemes, speak to Aspira. Significant savings can be made all round.

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Contacting Aspira

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