First Briefing, November 2024
Budget boosts salary exchange savings

Following the autumn Budget, introducing salary exchange for pension contributions has never been more of a win-win. It offers NI savings for both the employer and its employees.

We've yet to see exactly how the Budget will affect businesses. But we do know that despite all the rumours, the impact on pensions will be more subdued than we feared.

The Budget brings unspent Defined Contribution (DC) pots – and some Defined Benefit (DB) lump sum death benefits – into the inheritance tax regime from 2027.

Employer NI contributions (NIC) will rise from 13.8% to 15% from April 2025. And the threshold at which employers start paying NICs will go down from £9,100 pa to £5,000 pa.

These measures will dramatically increase costs for employers. For an employee earning £30,000 pa, the employer NIC level will increase by £866 pa.

This may make salary exchange more attractive, as a way of offsetting these increased NI costs.

Salary exchange

Salary exchange, or salary sacrifice, makes employees' pension contributions (and other employee benefits) more tax-efficient. It can be applied to both DB and DC schemes.

It generates NI savings for both employees and employers, giving the employee immediate and full tax relief on their pension contributions.

Although there has always been a degree of mistrust over its legitimacy, HMRC accepts its use, and even provides guidance on how to operate the arrangement (viewing it as a matter of employment law, not tax law).

How does salary exchange work?

Salary exchange involves employees giving up part of their salary. In exchange, their employer makes a matching pension contribution on their behalf, in addition to their normal contribution.

This reduction in gross salary requires a change to the members terms and conditions of employment, and can affect other benefits the employee receives, such as life cover. Most employers address this by maintaining a 'reference' (effectively pre-exchange) salary.

With salary exchange, NICs are only paid on the reduced salary, generating savings for both employers and employees. Due to the lower NIC, the employee's net take-home pay increases.

The thresholds from April 2025 for employee and employer NI rates will be:

Annual earnings	Employee NIC	Employer NIC
Up to £5,000	Nil	Nil
£5,001 to £12,570	Nil	15%
£12,571 to £50,270	8%	15%
Over £50,270	2%	15%

The table overleaf compares the NICs payable with and without salary exchange for an example member, who earns £30,000, with 5% of their salary (£1,500) paid into a DC scheme each year.

	Employee NIC	Employer NIC
Without salary exchange	(£30,000 - £12,570) x 8% = £1,394.40	(£30,000 - £5,000) x 15% = £3,750.00
With salary exchange	(£28,500 - £12,570) x 8% = £1,274.40	(£28,500 - £5,000) x 15% = £3,525.00
Annual savings	**£120**	**£225**

The employee sees an increase in their take-home pay of £120 pa, while the employer saves £225.

When applied across an entire workforce, salary exchange can generate substantial annual savings. Employers can choose how to use those savings – sharing some or all of them with employees, providing other benefits, or even retaining them.

For employers already operating salary exchange and rebating some or all of their employer NIC savings to top up pension contributions, the value of these top-ups rises automatically.

Is salary exchange suitable for everyone?

Care needs to be taken, as salary exchange arrangements may not be appropriate for all employees, especially those whose earnings fall below the lower earnings limit, set at £6,396 pa for the 2024/25 tax year. If an individual's earnings fall below this level, their entitlement to certain state benefits would be affected, including:

- New State Pension
- Statutory sick pay
- Employment and Support Allowance.

To overcome this, most employers set a minimum salary level for automatic inclusion.

Importantly, employees earning close to the National Minimum Wage (NMW) or the National Living Wage (NLW) – which in April 2025 will increase for over-21s to £12.21 (equivalent to £23,809 pa for employees on a 37.5 hour week) – should also be excluded from salary exchange. This is because it's illegal to pay someone less than those amounts.

An employee contributing 5% would need a full-time equivalent salary of around £26,000 to stay on or above this new threshold.

Because salary exchange isn't suitable for all employees, employers should agree which employees to include and exclude automatically as part of the implementation project.

Employers already operating salary exchange should make sure they're not affected by the NMW and NLW increases.

Communication

Communication is a key aspect of any pension change project and salary exchange is no exception. It's not an easy concept to explain to staff, who are often suspicious of an arrangement that involves giving up salary while promising to save them money!

It's possible to implement salary exchange with a simple letter varying the terms of an employee's contract. But in our experience, the more successful implementations use staff booklets, FAQs and staff presentations or webinars to explain the arrangement and maximise take-up.

Another factor which affects take-up is whether the arrangement is introduced on a positive affirmation basis (with employees electing to join) or on an opt-out or negative affirmation basis (with employees included unless they opt out). The latter option typically leads to significantly higher take-up. However, it does need to set it up correctly.

All salary exchange communications should be reviewed at least annually and updated with changes such as rates of income tax, NIC and earnings thresholds.

How First Actuarial can help you

To help you understand the NI savings that salary exchange can offer, we can model the benefits on your own pension scheme.

Our modelling can show potential savings for the employer and for individual employees.

We have considerable experience of designing, introducing and reviewing salary exchange arrangements with both DB and DC arrangements. We can also help communicate details of the arrangements to employees. Find out more about our salary exchange service.

To discuss how we can support you, contact your usual First Actuarial consultant, or one of our salary exchange specialists.