For employers

Your guide to salary sacrifice

A salary sacrifice arrangement lets you enhance your employees' benefit package – at no extra cost to you.

What is salary sacrifice?

Salary sacrifice is an arrangement between you and your employees. Employees give up part of their future gross salary or bonus in exchange for a non-cash benefit – in this case a pension contribution.

The employee chooses how much they want to exchange and their gross salary is reduced by this amount. You then pay this into their occupational or personal pension scheme as an employer contribution.

Making pension contributions in this way reduces the amount of National Insurance (NI) contributions you and your employees pay. These NI savings can be used to help boost employees' pension contributions or take-home pay.

You can make a further contribution to your employees' plans by passing back all or some of your NI savings. This is a great way of enhancing their benefits at no extra cost to you.

Setting up a salary sacrifice arrangement

To meet HM Revenue & Customs (HMRC) guidelines, the following conditions must apply:

- there has to be an employer/employee relationship;
- the pension scheme must be able to accept employer contributions and be:
  - an occupational or individual pension scheme;
  - a group or individual personal pension scheme; or
  - a stakeholder pension scheme (group or individual).
- the salary sacrifice agreement must apply to future earnings and be in place before the money is sacrificed.

What are the benefits?

Benefits to you

- You have no additional costs.
- The benefits package you offer your employees is improved.

Benefits to your employees

They can use salary sacrifice to:

- increase their pension contribution without affecting their take-home pay; or
- increase their take-home pay and maintain the same pension contribution.

Things to consider

Salary sacrifice isn't always suitable for everyone. Here are some of the key points you should think about before setting up a salary sacrifice arrangement.

National minimum wage (NMW)

By law, employees can't sacrifice their pay below the NMW rates.

Notional salary

A notional or reference salary is the employee's salary before salary sacrifice. You can retain this for employees so they can use this amount for mortgages, pay rises and overtime.

Employees who are off work

Even if the employee doesn't get sick pay or maternity pay, you may have to continue with the pension contribution, in line with the contract of employment.

Administration

Salary sacrifice creates extra administration, which can incur a higher cost, but you could use some or all of your NI savings to cover this. Your payroll administration may be affected, as payslips will need to be updated.

Employee considerations

Before entering a salary sacrifice arrangement, your employees should think about:

- whether the amount of salary they exchange moves them from a higher to lower tax band; and
- any benefits that are linked to their salary, including death benefits, redundancy payments, overtime rates and statutory benefits such as:
  - state pension;
  - maternity and sick pay;
  - working or child tax credit;
  - mortgage lending, which may be linked to their actual salary received; and
  - when they can make changes to a salary sacrifice arrangement (normally only once a year).

Setting up the arrangement

Step one – promoting salary sacrifice

To help promote the benefits of salary sacrifice, a range of promotional and joining material is available online in our support zone at **aegon.co.uk/support**

Salary sacrifice calculator

We've developed our salary sacrifice calculator especially for the corporate market. It allows you to perform bulk and member-level calculations, and create member-level letters and illustrations. The letters can be used to sign members up to the arrangement.

The two quote options for Aegon's calculator are:

1. keep the net take home pay the same – this allows the individual to keep their same net take home pay and increase the pension contribution by sacrificing some of their gross salary.
2. keep the pension contribution the same – this allows the individual to keep the same pension contribution and increase their net take home pay by sacrificing some of their gross salary.

When's the right time to look at salary sacrifice?

Salary sacrifice can be set up at any time. For example:

- you could introduce it when a new pension arrangement is set up;
- when the accounting year-end is approaching, you could include salary sacrifice in your financial plan;
- you could consider it if you are planning salary increases or profit-related bonuses; or
- if you have key employees (such as directors or high earners), they may be more receptive to this idea.

How it works

The example shows how a salary sacrifice arrangement might affect both you and an employee.

Salary sacrifice is being used to increase the pension contributions while maintaining the same take-home pay. Let's assume the employee is a 25 year old basic rate taxpayer, living in England, and earning £24,000 a year.

Before salary sacrifice you both contributed 5% of their salary to the pension scheme (£1,200 each). The government tops up the employee's contribution by 20%.

After salary sacrifice

Using salary sacrifice, the employee agrees to exchange £1,412 and you agree to pass on 100% of your NI savings.

The result

By reducing their gross salary, the employee reduces their tax and NI contributions. Coupled with your NI savings which have been passed on, they've increased their pension contribution from £2,400 to £2,807. That's an extra £407 a year paid into their plan without reducing their take-home pay or costing you any extra.

Maintaining pension contribution and increasing take-home pay

If the employee instead chooses to exchange £1,200 of their salary, their and your NI savings will go towards increasing their take-home pay.

Our bulk salary sacrifice calculator covers all of the options available.

Step two – signing members up

It's important that the arrangement is documented in writing as it constitutes a change to the original contract of employment. You must keep copies of all letters for legal purposes. Although it's no longer necessary to report sacrifice cases to HMRC, it may ask for copies of formal documentation at a later date.

Step three

You make the appropriate adjustments to the employee's salary, National Insurance and PAYE contributions.

Here's how it works for the employee:

	Before sacrifice	After sacrifice
Employee gross earnings	£24,000	**£22,588**
Income tax	£2,430	**£2,147**
NI contributions	£1,869	**£1,700**
Gross earnings less tax and NI contributions	£19,701	**£18,741**
Deduct current pension contribution (net of tax)	£960	–
Net disposable income	£18,741	**£18,741**

Here's how it works for you:

	Before sacrifice	After sacrifice
Employee gross earnings	£24,000	**£22,588**
Employer NI contributions	£2,149	**£1,954**
Employer pension contributions	£1,200	**£2,807 (your contribution + employee's salary exchange + your NI saving)**
Cost of employee to employer	£27,349	**£27,349**

Tax year 2018/19

Next steps

For more information on salary sacrifice, speak to a financial adviser.

You can also get details on HMRC's website: gov.uk/salary-sacrifice-and-the-effects-on-paye

If you have a new or existing pension scheme and are interested in salary sacrifice, speak to a financial adviser.

This information is based on our understanding of current legislation, taxation law and practice, which may change.

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