# Salary Exchange

A guide for clients

BWM, Castle Chambers, 43 Castle Street, Liverpool, L2 9SH
www.bwm.co.uk 0151 236 1494

**Cut the cost and boost pension funding with a great salary exchange rate**

## Introduction

Confirmation in the March 2016 Budget that pension salary sacrifice was not under any immediate threat was welcome news!

Employers are still able to offer salary sacrifice for mainstream employee benefits such as pension contributions, childcare vouchers or healthcare benefits. However, there will be a clamp down on its use with other fringe benefits which have separate rules for such items as cars, computers, wine etc.

For many, it will make financial sense to save into their pension using a salary sacrifice arrangement. However, it won't be right for everyone, such as lower paid employees or those needing to evidence income for mortgage applications etc.

With auto-enrolment contributions due to increase over the next few years, employers should look for ways to absorb this mandatory extra cost. Salary sacrifice could be the answer, as:

- The employer can offer a higher pension contribution for employees at no additional cost.
- It allows employees to save more for no extra cost too.
- And it's a great way to attract and retain staff by offering a benefits package which includes pension contributions above the auto-enrolment minimums.

## Key points

- Most are aware that there is tax relief on pension savings but don't appreciate the 'hidden tax' that is NI?
- Salary sacrifice produces an NI saving for both the employee and employer, which can significantly reduce the cost of pension provision.

## How does salary sacrifice work?

The employee agrees to change their employment contract to give up part of their salary in return for an extra employer contribution to their pension.

As the employee's salary is reduced, they and their employer pay less NI. The employee can therefore pay more into their pension at no extra cost and the employer money saved <u>can</u> be passed onto, or shared with, the employee as a higher pension contribution (but doesn't have to be).

Employees can continue to pay the same amount into their pension each month and benefit from an increase in their take home pay equal to the NI saving. **Or**, they can choose to boost their pension with the NI savings, leaving them with the same take home pay as before and a bigger future pension provision.

Detailed below is an example for an employee earning £36,000 who currently pays 5% of the salary into a workplace pension and who increases their pension funding with their own and the employer's NI saving.

| | Before sacrifice | After sacrifice | Tax and NI savings paid to pension |
|---|---|---|---|
| Gross salary | £36,000 | £33,882 | |
| Olivia's gross contribution (5%) | £1,800 | | |
| Income tax paid | £4,640 | £4,576 | £64 |
| Employee NI | £3,353 | £3,099 | £254 |
| **Take home pay** | £26,207 | £26,207 | |
| | | | |
| Employer NI | £3,848 | £3,556 | £292 |
| | | | |
| **Total paid into pension** | £1,800 | £2,410 | |
| **'Boost' due to sacrifice** | | | £610 |

**Position for Higher rate taxpayers**

Earnings over £43,000 (currently) are subject to NI at just 2%. So the savings available under salary sacrifice aren't as great as those of basic rate taxpayers who can save 12% by giving up salary.

The savings are still worthwhile – however especially if the employer is also prepared to add their NI savings to the pension contribution.

So a higher rate taxpayer sacrificing £10,000 would save £200 in employee NI. But they could also benefit from the employers NI saving worth £1,380.

Additionally as salary sacrifice reduces the amount of salary received, all tax relief is given immediately and paid directly into the pension you don't have to wait to claim this on an annual tax return.

**FOR GENERAL INFORMATION ONLY**

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so.  It is designed to alert clients to some of the issues.  It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

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