

Benefits Brief

Employee Edition

April 2024

An employee guide to salary exchange – frequently asked questions

What is salary exchange?

Salary exchange (also known as ‘salary sacrifice’) is a fairly simple concept. It’s an arrangement between you and your employer where you request to reduce your salary in exchange for a contribution into your pension.

How does it work?

You agree to reduce your salary, giving up a percentage that you wish your employer to pay directly into your pension, before any National Insurance or tax is deducted. This reduces your annual gross salary, but because it decreases the amount of National Insurance you pay, it reduces the cost of your pension contribution, but the same amount is still paid into the pension.

For those earning less than £50,270 for the tax year 2024/25 this equates to a 8% NI saving. If you earn more than £50,270 you will save 2% National Insurance (NI) on the amount you exchange on earnings above this threshold.

What are the other advantages of salary exchange?

Instead of increasing your net income, salary exchange can be used to increase the amount going into your pension scheme without affecting your current net income. Your contributions to your pension increase by an amount equivalent to the NI saving. This means that you will benefit from the saving, plus tax relief, being invested into your pension. You can also use salary exchange to keep within certain tax brackets, or to reclaim benefits you may have previously lost, for example child benefit.

Are there any other disadvantages?

It's important to note that salary exchange may not be appropriate for everyone. When you apply for a mortgage, most lenders now look at affordability, however a small number of lenders still use a multiplication of salary to calculate affordability. With these lenders a salary exchange arrangement could have an adverse effect on your borrowing capacity. Your employer can provide a letter, if needed, confirming your pre-exchange salary and that you are part of a salary exchange scheme.

Salary exchange could also affect your entitlement to some state benefits. If your earnings fall below a certain limit (currently £6,396 for the tax year 2024/25), you won't be eligible for some state benefits such as statutory sick pay; statutory maternity, paternity or adoption pay; incapacity benefit; jobseekers' allowance and tax credits.

Is salary exchange right for me?

Salary exchange should not reduce your pay below the national living wage. So, if you are working full-time and earn around £19,000 or less then you should carefully consider whether salary exchange is right for you.

My employer runs the salary exchange arrangement on a 'negative affirmation' basis. What does this mean?

If your employer runs this arrangement on a negative affirmation basis then they'll automatically arrange for your pension contributions to be made via salary exchange, providing you do not earn below the minimum earning threshold that your employer has set.

If you decide that you don't want to make your pension contributions via salary exchange, then you can opt-out. You should contact your HR department to let them know.

Which figure will be used as a base figure for future wage reviews and redundancy calculations?

There is usually no change to how the figures will be calculated, your employer will usually continue to use your pre-exchange salary. The New Actual Salary/Pay is your new gross salary/pay after all deductions via salary exchange. This includes for example pension contributions, childcare vouchers, and cycle to work scheme where relevant.

What is the maximum % of salary I can exchange?

Your employer will usually have a maximum that they will allow you to exchange. You cannot exchange salary which means you would receive less than the National Minimum/Living Wage.

This does not mean you can't pay pension contributions above this amount just that they can't be paid using salary exchange.

What is the annual threshold for pension contributions?

The annual allowance is a limit on the amount that can be contributed to your pension each year, while still receiving tax relief. It's based on your earnings for the year and is capped at £60,000. If you have taxable income over £200,000 your annual allowance may be less than this. For more information on this please visit this link: <https://www.gov.uk/tax-on-your-private-pension/annual-allowance>.

I pay income tax on my salary that is higher than the basic rate, how does salary exchange impact me?

If you pay income tax at a rate higher than the basic rate (20% for 2023/24) then you would previously have had to claim your additional tax relief directly from HMRC. This may have been through a self-assessment tax return or by receiving an adjustment to your tax code. The good news is that when you use salary exchange you will receive all of the tax relief you are entitled to immediately without having to make any further claims.

It is important however that you notify HMRC immediately that you are moving to salary exchange so that you don't receive your tax relief twice and build up an unexpected tax bill. You can notify HMRC by phone or using their online chat service. The contact details are here: [Income Tax: general enquiries - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/organisations/hm-revenue-and-customs/about/contact-us)

Where can I find out more about salary exchange?

If you want to find out more about salary exchange, you can visit the Money Advice Service website; <https://www.moneyhelper.org.uk/en/pensions-and-retirement/building-your-retirement-pot/salary-sacrifice-and-your-pension>

The information contained within this guide is based on Secondsight's understanding of current legislation which may change in the future. The value of any tax relief depends upon your financial circumstances. Tax rules may change.

This information has been put together using reasonable care to ensure its accuracy. We cannot guarantee that such information is free from errors or inaccuracies.