

Salary Sacrifice

Salary Sacrifice is where an employee sacrifices part of their salary and/or bonus in return for their employer paying the amount sacrificed as an employer pension contribution on their behalf.

Such an approach can be far more attractive than the employee making a direct pension contribution on his/her own behalf, particularly where their employer is prepared to increase the employer pension contribution by part or all of their National Insurance saving.

The following example, based on a 40% UK (non-Scotland) taxpayer, will help to demonstrate this. All figures are shown yearly.

Example

The phasing out of the personal allowance at income between £100,000 and £125,140 creates an opportunity for salary sacrifice planning.

In the example, a salary sacrifice of £13,004 gives the same net income as if the pension contribution had been paid personally. By also passing on the employer NIC saving of £1,951 (£13,004 x 15% employer rate), the total pension contribution will be £14,955.

	No pension contribution (£)	Personal pension contribution (£)	Salary sacrifice pension contribution (£)
Taxable income	112,570	112,570	99,566
Employee pension contribution (net)	0	10,056	0
Personal Allowance	6,285	12,570	12,570
National Insurance (employee)*	4,262	4,262	4,002
Tax (employee) after any higher rate relief	34,974	29,946	27,258
Take home pay	73,334	68,306	68,306
Employer contribution	0	0	14,955

* National Insurance band £12,570 – £50,270 at 8%, 2% on excess.

These figures are based on the yearly National Insurance and income tax rates for the 2025/26 tax year.

Note: For Scottish taxpayers, the Scottish Rate of Income Tax may produce a different result to the rest of the UK due to the different tax rates and bands.

Note: For Welsh taxpayers, the overall rates of income tax payable will be the same as UK taxpayers (excluding Scotland).



Timing of salary sacrifice

For a salary sacrifice to be effective it must be made before the remuneration being given up is treated as received for employment income tax purposes.

For an employee this will normally be the earlier of:

- the date the payment is made, and
- the time the individual becomes entitled to the payment.

Where a company director is concerned, the following additional dates also need to be considered:

- the date when remuneration is credited in the company's accounts or records
- where the remuneration is determined during the course of a company's accounting year (or other period in respect of which the remuneration is paid) it is deemed to be paid at the end of that year or period
- where the amount of remuneration is determined after the end of the period to which they relate, the date the amount is determined.

Where there is any doubt as to the date a director's remuneration becomes assessable to tax as employment income this should be checked with the company or the director's accountant.

HMRC's Employment Income Manual sets out the criteria for a successful salary sacrifice from page EIM42700 onwards.

This represents Zurich's understanding of salary sacrifice arrangements in connection with pension contributions. This is subject to change and Zurich does not accept responsibility for any action taken or refrained from, by any person relying on this information.

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Tapered Annual Allowance

'High-income' individuals need to be aware that there is a reduction in the standard Annual Allowance where their "Adjusted Income" exceeds £260,000 and their "Threshold Income" exceeds £200,000. Both limits need to be breached for tapering to apply.

The Annual Allowance reduction is £1 for every £2 of Adjusted Income over £260,000, subject to a minimum £10,000 Annual Allowance applying.

The definitions of Adjusted Income and Threshold Income aren't straightforward but, broadly, "Adjusted Income" refers to all taxable income plus employer pension contributions for the tax year, and "Threshold Income" to all taxable income less personal contributions for the same period.

Please be aware that anti-avoidance measures are in place for anyone entering into a salary exchange or flexible remuneration arrangement on or after 9 July 2015 in order to avoid or reduce the impact of the Tapered Annual Allowance.

Please note that the Adjusted Income and Threshold Income amounts have previously been:

- between 6 April 2016 and 5 April 2020, £150,000 and £110,000 respectively, subject to a minimum £10,000 Annual Allowance applying, and
- between 6 April 2020 and 5 April 2023, £240,000 and £200,000 respectively, subject to a minimum £4,000 Annual Allowance applying.

Other considerations

Where any employee is assessing a salary sacrifice arrangement it is important to consider the impact the salary sacrifice may have on other benefits. For example, if the individual is a member of an occupational pension scheme or a group life scheme, the reduced salary may result in a reduction of his benefits, unless the employer is prepared to continue to base those benefits on their pre-sacrifice salary.

Similarly a reduced salary could potentially reduce the loan available to an individual seeking a mortgage.

For lower paid employees the impact of a reduced salary on state benefits and the impact of the national minimum/living wage should also be assessed – note that a salary sacrifice arrangement must not reduce an employee's earnings below the national minimum rates.

Key point summary

The attractions of salary sacrifice when making pension contributions should not be ignored.

However, it is important to consider the impact salary sacrifice may have on other benefits and the implications on entering into an arrangement to avoid the Tapered Annual Allowance.