

# Looking after the pennies and the pounds

An employer guide to salary exchange



**Whether you've an existing pension scheme or want to set up a new one, a salary exchange arrangement could help you save money and improve the benefits package you offer your employees.**

## **What is salary exchange?**

You've probably heard of salary exchange, sometimes referred to as salary sacrifice, but may not be familiar with what it is.

Put simply, it's an agreement between you and your employees, where they agree to exchange part of their gross salary, bonus or even redundancy package for a pension contribution.

It works in the same way as other salary related benefit schemes, for example company car, cycle to work and childcare voucher schemes.

## **Why should I choose salary exchange?**

Salary exchange is a simple, tax efficient way for you to save money on your workplace pension scheme and improve the benefits package you offer your employees.

The main advantage is both you and your employees pay less National Insurance contributions (NIC) and employees will pay less income tax.

You can then choose how to reinvest those savings. So you can keep some or all of your savings to reinvest back into your business, or pass some or all on to your employees, by adding it to their pension contribution.

You can also decide if your employees savings will be reinvested in their pension or their take home pay. Alternatively you can give them the choice, although this additional flexibility increases the administration for you.

Whichever option you choose, there's no increased pension contribution cost.

## Salary exchange in practice

We've provided some examples to show how salary exchange could benefit you and your employees.

### Savings at scheme level

The examples below highlight how much NI contributions can be saved by introducing salary exchange and keeping all of the savings.

Your adviser can help you calculate what your savings will be if you choose to introduce this arrangement.



#### 50 scheme members

Total yearly salary payment before exchange **£1,500,000**

Total salary exchanged  
by employees (5%)

**£75,000**

Employer NIC rate  
(2023/24)

**x 13.8%**

Employer  
yearly NIC saving

**£10,350**



#### 100 scheme members

Total yearly salary payment before exchange **£3,000,000**

Total salary exchanged  
by employees (5%)

**£150,000**

Employer NIC rate  
(2023/24)

**x 13.8%**

Employer  
yearly NIC saving

**£20,700**



#### 500 scheme members

Total yearly salary payment before exchange **£15,000,000**

Total salary exchanged  
by employees (5%)

**£750,000**

Employer NIC rate  
(2023/24)

**x 13.8%**

Employer  
yearly NIC saving

**£103,500**

Figures are based on an average salary of £30,000 per employee, each exchanging 5% of their salary for a pension contribution. Employer yearly savings are the NI contributions that would be paid without salary exchange in place.

## Savings and benefits at employee level

Your employees can benefit from salary exchange in a number of ways, depending on how your arrangement is set up.

The following examples look at the costs, savings and benefits if you choose to reinvest all savings, or no savings. They include salaries for basic rate and higher rate taxpayers, and we've used standard automatic enrolment (AE) contribution rates of 3% employer and 5% employee. Higher level pension contributions will provide higher NI and income tax savings.

### Example 1: All savings are reinvested into your employee's pension plan

	Before salary exchange	After salary exchange	Before salary exchange	After salary exchange
<b>Salary</b>	£27,000	<b>£25,411</b>	£55,000	<b>£52,155</b>
<b>Employee</b>				
Pension contribution	£1,080	£0	£2,750	£0
Income tax payment	£2,886	£2,568	£8,882	£8,294
NIC	£1,731	£1,541	£4,618	£4,561
<b>Employer</b>				
Pension contribution	£810	£2,617	£1,650	£4,887
NIC	£2,470	<b>£2,251</b>	£6,334	<b>£5,941</b>

Outcome	Before salary exchange	After salary exchange	Before salary exchange	After salary exchange
Employee take home pay	£21,302	<b>£21,302</b>	£39,299	<b>£39,299</b>
Total pension contributions	£2,160	<b>£2,617</b>	£4,400	<b>£4,887</b>
Cost to employer (incl. salary)	£30,280	<b>£30,280</b>	£62,984	<b>£62,984</b>

#### What this means for you

- You pay your employee 5.17% less salary.
- Pension contributions increase by 5.89% to a total of 8.89%.
- There's no change to your costs.

#### What this means for your employee

- They'll exchange 5% of their salary for an additional 5% employer pension contribution.
- There's no change to their take home pay.
- Employees earning:
  - £27,000, benefit from an extra £457 pension contribution in the first year
  - £55,000, benefit from an extra £487 pension contribution in the first year.

All figures are based on tax and NI rates for the 2023/24 tax year and rounded down to the nearest £.

**Example 2: No savings are reinvested into your employee's pension plan.**

	Before salary exchange	After salary exchange	Before salary exchange	After salary exchange
<b>Salary</b>	£27,000	<b>£25,650</b>	£55,000	<b>£52,250</b>
<b>Employee</b>				
Pension contribution	£1,080	£0	£2,200	£0
Income tax payment	£2,886	£2,616	£8,882	£8,332
NIC	£1,731	£1,569	£4,618	£4,563
<b>Employer</b>				
Pension contribution	£810	£2,160	£1,650	£4,400
NIC	£2,470	<b>£2,283</b>	£6,334	<b>£5,954</b>

Outcome	Before salary exchange	After salary exchange	Before salary exchange	After salary exchange
Employee take home pay	£21,302	<b>£21,464</b>	£39,299	<b>£39,354</b>
Total pension contributions	£2,160	<b>£2,160</b>	£4,400	<b>£4,400</b>
Cost to employer (incl. salary)	£30,280	<b>£30,093</b>	£62,984	<b>£62,604</b>

**What this means for you**

- You pay your employee 5% less salary.
- Pension contributions increase by 5% to a total of 8%.
- In the first year, you save:
  - £186 in NI contributions per employee earning £27,000
  - £380 in NI contributions per employee earning £55,000.

**What this means for your employee**

- They'll exchange 5% of their salary for an additional 5% employer pension contribution.
- There's no change to the total value of pension contributions paid into their plan.
- Employees earning:
  - £27,000 save £432 in tax and NI contributions in the first year
  - £55,000 save £605 in tax and NI contributions in the first year.

This is then added to their take home pay and reflected in their exchanged salary amount. This is slightly higher than the exchanged salary in example 1, where savings are paid into their pension plan.

All figures are based on tax and NI rates for the 2023/24 tax year and rounded down to the nearest £.

## Setting up salary exchange

If you're concerned that setting up a salary exchange arrangement could be complicated, then rest assured it can be a relatively straight forward process.

You can offer the arrangement to some or all your employees, so long as their reduced salary doesn't fall below the minimum wage.

They'll just need to agree to an altered contract of employment, which can be done through an agreement letter or an opt-out option.

So when you're adding someone to your scheme or enrolling them back in, you'll need to ensure their altered contract of employment is in place before you apply the exchange. If it isn't, their contributions should be taken from their pay after tax has been deducted. This is known as the relief at source basis.

Employees can choose to opt-out of the arrangement at any time and still pay into their plan without exchanging part of their salary. The plan continues, but on a relief at source basis.

## Some things to consider

- There can be an increased level of administrative and HR work required with a salary exchange arrangement. You can manage those levels by having a default approach to how savings are reinvested, for example, all employee savings are invested into their pension plan.
- You'll need to ensure your employee payslips display the amount of the salary exchanged. Can your payroll do this, or will it require additional resource?
- Salary exchange may not be suitable for employees on furlough, as you can't claim the exchanged portion of their salary through the Job Retention Scheme.
- Salary exchange may not be suitable for employees earning more than £260,000 with a tapered annual allowance. If this applies to any of your employees, they could incur additional annual allowance tax charges.
- Because your employees' yearly pre-tax salaries will reduce by agreeing to salary exchange, it can affect their entitlement to things such as statutory and salary related benefits
- In the past this may also have impacted the amount they can borrow in terms of a mortgage or loan. These days most lenders will calculate lending based on the notional salary – their salary before the exchange.
- As tax treatment depends on your employees circumstances, and could change in future, the level of savings could change in line with this.

## Redundancy exchange

No one knows what the future holds. If you find that you need to reduce your staff levels you can offer your employees the option to exchange part of their redundancy package too.

## We're here to help

To help you engage with your employees and help them understand the long-term value of salary exchange, we've created a suite of materials for you to use with them.

They include information on what's involved, some of the things they should consider and the benefits of salary exchange. There's some example cases to see how salary exchange works in practice.

You can use our [salary exchange calculator](#), to demonstrate the benefits of salary exchange and to provide illustrations for each of your employees. If you'd like these calculations at scheme level, your adviser will be able to help.

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For more information about salary exchange speak to your financial adviser or visit [employer.royallondon.com/salary-exchange](https://employer.royallondon.com/salary-exchange)



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