Salary exchange

A guide for members

If you're paying into your company pension scheme to provide for your retirement, you can take advantage of the benefits offered through salary exchange.

What is salary exchange?

Salary exchange is an arrangement between you and your employer in which you agree to give up part of your salary or bonus in exchange for your employer making payments into your pension plan.

What are the benefits?

You and your employer will both pay lower **National Insurance Contributions (NICs)** on your reduced salary. You may also pay less income tax.

As an **employee**, you can use your NIC and tax savings to:

- increase your payments into your pension plan
- increase your take home pay.

Remember, the value of your pension can go down as well as up and is not guaranteed. You could get back less than has been paid in.

How does it work in practice?

To see how salary exchange might affect your salary and pension payments we'll look at an example case, that of John Smith. John is paid an annual salary of £20,000. He pays £1,000 (gross) into his pension plan each year and his payments are matched by his employer, taking his total pension payments for the year to £2,000.

- With salary exchange, John would stop making payments himself and agree to 'exchange' £1,000 of his salary for his employer making payments into his pension plan.
- John's employer would reduce his salary to £19,000 and pay the 'exchanged' amount (£1,000) into his pension plan, along with the £1,000 they already pay on his behalf.

	Before salary exchange (£)	After salary exchange (£)
Salary	20,000	19,000
John's pension payment	1,000	0
Employer pension payment	1,000	2,000
Total pension payment	2,000	2,000
Take home pay	Using salary exchange, John will pay lower NICs on his reduced salary which will increase his take home pay. Or, John could choose to exchange slightly more salary to increase his total pension payments and keep his take home pay the same.	

This table is only for illustrative purposes.

Deciding how to use your savings

There are a variety of ways salary exchange can be set up depending on how you choose to use your NIC and tax savings. You may benefit from:

1) A boost to your pension provision.

Scenario 1	Pension contribution	Take home pay
You agree to exchange some salary so that your current pension payments can be paid by your employer. Your take home pay stays the same, and the saving you make in NICs is paid into your pension plan.	↑	↔

2) An increase to your take home pay.

Scenario 2	Pension contribution	Take home pay
You agree to exchange some salary so that your current pension payments can be paid by your employer. Your total pension payments stay the same, and the saving you make in NICs is used to increase your take home pay.	↔	↑

3) A boost to your pension provision and an increase to your take home pay.

Scenario 3	Pension contribution	Take home pay
You agree to exchange some salary so that your current pension payments can be paid by your employer. The saving you make in NICs is divided so that some is paid into your pension plan and some is used to increase your take home pay, although each to a lesser extent than in either of the above scenarios.	↑	↑

4) The option to exchange additional salary for payments into your pension plan from your employer. Exchanging extra salary for pension payments will cause your take home pay to go down.

Scenario 4	Pension contribution	Take home pay
If you want to take advantage of the savings available through salary exchange and invest more into your pension, you can specify an amount of salary you'd like to exchange for payments into your pension plan from your employer.	↑	↓

Some things to bear in mind

Before going ahead, you should be completely sure salary exchange is the right option for you. Reducing your salary through salary exchange involves making changes to your contract of employment and it is important to be aware of the implications this may have. Here are some of the things you will need to bear in mind.

- The reduction in your salary could affect your entitlement to statutory benefits, such as the state pension, child and working tax credit and statutory sick pay.
- Your entitlement to other salary-related benefits may also be affected. These could include bonuses, overtime pay and redundancy payments.
- Mortgage lenders usually base the amount they lend on the salary after exchange, which could mean that the maximum mortgage available to you is lower than it might otherwise be. To help avoid this, your employer can retain a notional salary for you (salary before exchange), as mortgage lenders may use this in their decision making.
- You cannot participate in salary exchange if it results in your salary falling below the national minimum wage or national living wage.

If you have any doubts regarding its suitability for you, we recommend that you seek financial advice. If you do not have a financial adviser, you can find one at www.unbiased.co.uk. You may be charged for financial advice.

This guide is based on our understanding of current tax laws. These laws and our understanding of them may change in the future.
Tax treatment will depend on your individual circumstances and may be subject to change in the future.

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