A guide for employees

Salary exchange and pension (including bonus exchange)

Did you know that salary exchange (also known as salary sacrifice, SMART Pensions and Smart Pay) can provide you with an opportunity to increase your pension contributions without affecting your net income (this is the income left after you've paid tax and national insurance contributions)?

What is salary exchange?

A salary exchange scheme is an arrangement between you and your employer in which you agree to a reduction in your salary or bonus, and in return you receive a benefit. The benefit here is a contribution by your employer of an equivalent amount into your pension. This way you can save on income tax and both you and your employer can save on national insurance contributions (NIC).

The exchange is achieved by varying your terms and conditions of employment as you're giving up your contractual right to future cash payments of the amount exchanged.

Advantages of salary exchange for you

- Salary exchange can be used to maintain your level of pension savings and see an increase in your net take home income.
- Or, salary exchange can be used to boost your pension savings while leaving your net take home income unchanged.
- You can save NIC of 8% of the amount exchanged on earnings above the primary threshold (£12,570 for tax year 2024/25). For any earnings above the upper earnings limit (£50,270 for tax year 2024/25) your NIC saving will be 2%.
- Your earnings that would be taxed can be exchanged into pension contributions which aren't taxed.
- It provides you with a tax-efficient way to save for your retirement.

Depending on your circumstances there may be disadvantages to salary exchange and it's important you understand these. **We explain these in 'What you need to be aware of about salary exchange' on page 3, and it's important you read this section.**

How is salary exchange arranged?

Strict rules apply to salary exchange to protect both you and your employer. The following factors laid down by HM Revenue & Customs (HMRC) for salary exchange need to be met:

- Your terms and conditions of employment need to be revised.
- This revised contract must state that you're entitled to a lower cash payment and separately a benefit (in this case an enhanced employer pension contribution) as a result of an exchange.
- The agreement between you and your employer must refer to the benefit being given for the salary exchange.
- Only your entitlement to future salary can be exchanged and this must be done before it's treated as received for tax purposes.

The information contained in this guide is based on Aviva's interpretation of current legislation, taxation law and HMRC practice for the 2024/25 tax year, which may change in the future.

The value of any tax relief depends on your financial circumstances.

The purpose of this table is to demonstrate the amount by which your net (take home) income increases under salary exchange whilst maintaining the same total pension contribution.

You can also choose to use the savings generated by salary exchange to increase your pension contribution which would mean that your take home income would be the same.

This is just an example calculation and how much you save will depend on by how much you choose to reduce your monthly pay.

Basic rate tax payer		
	Non-salary exchange	**Salary exchange**
Annual salary	£30,000	£28,500
Monthly salary	£2,500	£2,375
Employee contribution before tax relief	£100	£0
Employee contribution after tax relief added	£125	£0
Tax	£290.50	£265.50
National Insurance	£116.20	£106.20
Take home pay*	***£1,993.30**	***£2,003.30**
Employer contribution	£125	£250
Total invested per month in pension	**£250**	**£250**
Employer monthly NI saving which they may choose to re-invest in your pension	£0	£17.25
***Take home pay is £15 per month greater under salary exchange**		

Higher rate tax payer		
	Non-salary exchange	**Salary exchange**
Annual salary	£60,000	£58,500
Monthly salary	£5,000	£4,875
Employee contribution before tax relief	£100	£0
Employee contribution after tax relief added	£125	£0
Tax	£952.67	£902.67
National Insurance	£267.55	£265.05
Take home pay*	**£3,704.78**	***£3,707.28**
Higher/Additional tax relief reclaimed via self-assessment	**£25**	
Final net income allowing for higher rate reclaim	***£3,500.05**	**£3,504.61**
Employer contribution	£125	£250
Total invested per month in pension	**£250**	**£250**
Employer monthly NI saving which they may choose to re-invest in your pension	£0	£17.25
***Take home pay is £2.50 per month greater under salary exchange (after allowing for the higher rate tax relief that is claimed through self-assessment in the non-salary exchange scenario).** **Please note, the examples in this guide aren't appropriate for Scottish tax payers.**		

Example monthly payslip

Employee Name	Employee Number	

Tax Period
Tax Code
N.I Number
N.I Code

Payments

Description	Cash
Reference salary	£2,500.00
Salary exchange	-£125.00
Payments	**£2,375.00**

Deductions

Description	Cash
Tax	£265.50
NI – EE	£205.64
Deductions	**£471.04**

This Period

Description	Cash
Taxable Pay	£2,375.00

Year-To-Date

Tax
NI – D
Taxable Pay
NICable

Net Pay	**£1,903.36**

Paid By BACS
Sort Code
Account Number

The reference salary is your pre-exchange salary.

Salary exchange shown on a standard payslip as a reduction to salary before tax and NIC.

There is not a set way in which salary exchange needs to be demonstrated on a payslip. Much of this will depend on the payroll system your employer uses and whether employee benefits are based on the higher or reduced gross salary.

What you need to be aware of about salary exchange

Like any financial decision salary exchange is not suitable for everyone. You should be aware of the potential drawbacks and take these into account before deciding.

You need to be aware that salary exchange could affect your current or future entitlement to a range of state benefits, including the receipt of tax credits.

If your earnings (after salary exchange) fall below a certain limit (currently £6,396* a year), you won't be eligible for:

- statutory sick pay;
- statutory maternity, paternity or adoption pay;
- incapacity benefit;
- jobseeker's allowance (although means-tested benefits may still be claimed).

If you've not paid enough NIC on your income, state pension benefits may also be reduced on retirement.

*2024/25 limits

Salary exchange should not reduce your cash pay to below the national minimum wage. This means that if you're working full-time and earn around £15,000 a year or less, you should take care when considering any salary exchange scheme.

Any amount that you exchange is taken from your pay before tax is deducted. If you're a non-taxpayer (you earn less than your personal allowance), you don't benefit from the tax relief that a taxpayer would receive. If you're paying into a personal pension, it may be more cost effective to pay personal contributions rather than use salary exchange, as personal contributions are automatically deducted net of basic rate tax relief regardless of the amount you earn.

Other possible impacts are on your borrowing levels, such as mortgage borrowing, credit card and personal loan limits, income protection insurance benefits and redundancy entitlements.

Pay-related benefits, such as overtime payments, life insurance, salary increments and final salary pension benefits, may be calculated on your 'reference' salary, i.e. your salary before the exchange. This will depend on what your employer has stated in your employment contract.

Bonus exchange

In the same way that you can exchange earnings for a non-cash benefit, such as pension contributions, if your employer allows, you can also exchange some or all of your bonus.

Contact your employer if you're unsure whether bonus exchange is available to you.

If you want to exchange part or all of future bonuses, you will also need to ask your employer whether this is something they cater for. You may need to agree bonus exchange each time a bonus is about to be offered to you.

Things to be aware of about bonus exchange

- The bonus must be exchanged before you receive it.
- You cannot change your mind once you've agreed to exchange the bonus.
- Bonus exchange can also affect your entitlement to state benefits.

You're a basic rate tax payer

Your employer offers you £10,000 bonus which you can take as cash or a pension payment

Non-salary exchange: If you take cash you pay £2,000 income tax	**Salary exchange:** If you take the bonus as a pension payment your employer pays £10,000 into your pension
You pay £800 NI	Your employer may pay their NI saving of up to £1,380 into your pension†
You receive a net bonus of £7,200	**Your total pension investment is up to £11,380**

You're a higher rate taxpayer

Your employer offers you £10,000 bonus which you can take as cash or a pension payment

If you take cash you pay £4,000 income tax	If you take the bonus as a pension payment your employer pays £10,000 into your pension
You pay £200 NI	Your employer may pay their NI saving of up to £1,380 into your pension†
You receive a net bonus of £5,800	**Your total pension investment is up to £11,380**

†**Your employer will decide how much of their saving will go into your pension. Not all employers contribute NI savings.** The maximum amount is 13.8% of the bonus. These calculations assume the employer contributes the maximum amount of their NI saving into your pension.

Questions & answers

If I decide not to opt for salary exchange initially, when can I join in the future?

Joining a salary exchange scheme is subject to eligibility, the terms and conditions of the scheme, your acceptance of a change to your contract of employment, and the scheme continuing in existence. You'll need to check with your employer if you can join the salary exchange scheme at a later date.

Can I withdraw from salary exchange at any time?

Subject to the rules of the salary exchange scheme of your employer, you can withdraw from salary exchange for pension at any time although you'll need to check with your employer to find out when you'll be able to choose salary or bonus exchange again.

Are there any restrictions on eligibility for salary exchange?

There are certain restrictions on eligibility. At any time during your employment your gross pay must not fall below the national minimum wage or national living wage rates, either before or after the salary exchange reduction. The rates from 6 April 2024 are:

- £8.60 for those aged 18–20
- £11.44 for those aged 21 and over.

You aren't able to exchange statutory maternity, paternity, adoption pay or sick pay. If you've already joined the scheme before taking maternity, paternity or adoption leave, you'll receive statutory maternity, paternity or adoption pay in full and employer contributions will be maintained at the level they were prior to you taking the leave, including the amount you would have been sacrificing. While in receipt of statutory sick pay, employer contributions will be based upon your sick pay received at the percentage agreed under your salary exchange agreement.

How will salary exchange affect my tax credits?

Tax credits are benefits for families with children and working people on low incomes. The amount of tax credits you receive depends on your total family income and your own family circumstances.

HMRC administers tax credits and for more information on how salary exchange could affect the amount of tax credits you receive, call the tax credits helpline on **0345 300 3900**.

If I work additional hours, what rate will I get paid?

Your terms and conditions of employment with your employer will show whether your overtime pay is based on your salary before or after exchange.

If I apply for a mortgage, a loan or similar financial transaction, what should I quote as my earnings?

You should quote your revised gross pay (following salary exchange). If you decide to opt for salary exchange to boost your pensions savings, generally your net spending income will remain unchanged. However, your gross pay will be reduced due to salary exchange and this may impact your ability to qualify for a mortgage or loan.

What happens if I take unpaid leave?

While you're taking unpaid leave, you won't be able to participate in a salary exchange agreement. Any employer's contributions can usually continue to be paid into your pension; however, they aren't bound by law to do this.

What is the effect of salary exchange on how much I can pay in?

You can pay as much as you want into a pension scheme, however, HMRC puts a limit on the total amount you can pay before a tax charge is payable. For the 2024/25 tax year this annual allowance is £60,000. If you've flexibly accessed any of your pensions you'll usually be subject to a reduced allowance of £10,000 (2024/25) tax year in respect of your money purchase pension savings.

If you earn more than £200,000 in threshold income (2024/25), your annual allowance may be reduced and a 'tapered annual allowance' may apply. From 9 July 2015 any new or renegotiated amounts exchanged from pay have been included when determining threshold income. This prevents the use of salary exchange to avoid the tapered annual allowance. If you're a high earner and you think this may affect you, please speak to a financial adviser.

For more information please visit: **gov.uk/tax-on-your-private-pension/annual-allowance**

Where can I get independent financial advice?

If you don't already have a financial adviser, you may be able to find one at **unbiased.co.uk**. You may be charged for this advice.

What are the charges for joining the salary exchange scheme?

You'll need to check with your employer if there are any costs associated with salary exchange.

Can I exchange any redundancy payment?

Yes, you should be able to exchange all or part of a redundancy payment, if your employer provides this facility. Any amount exchanged is classed as an employer contribution and does not attract tax relief. As the first £30,000 of redundancy pay is normally free of both tax and NI, there are few benefits to sacrificing this amount. Any amount over £30,000 is subject to income tax at your normal rate, though again there should be no NI liability. You could therefore save income tax on any amount exchange over £30,000. This means that the benefits of exchanging redundancy pay aren't as clear cut as with salary or bonuses.

Other amounts you may be paid around the time of redundancy, such as Pay in Lieu of Notice, Gardening Leave or pay for holiday not taken are all subject to the usual tax and NI deductions. In principle, it should therefore be possible to exchange them subject to the same national minimum wage requirements as any other salary. However, you would need to talk to your employer about that as part of the process of agreeing your redundancy package. No part of it can be exchanged after the package has been agreed.

You should take professional advice before making a decision. You may be charged for this advice.

For more information on redundancy payments, visit the HMRC website at: **gov.uk/calculate-your-redundancy-pay**

If you're ready to take advantage of salary exchange, please contact your employer.

Need this in a different format?

Please get in touch if you'd prefer this guide **(NG08052)** in large print, braille, or as audio.

Aviva Pension Trustees UK Limited.
Registered in England No. 2407799. Aviva Wellington Row, York YO90 1WR.
Authorised and regulated by the Financial Conduct Authority. Firm reference number 465132.

Aviva Life & Pensions UK Limited.
Registered in England No. 3253947. Aviva, Wellington Row, York YO90 1WR.
Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. Firm reference number 185896.
My Money is a registered trademark of the Aviva group.

Aviva Investment Solutions UK Limited.
Registered in England No. 6389025. Aviva, Wellington Row, York YO90 1WR.
Authorised and regulated by the Financial Conduct Authority. Firm reference number 515334.
My Money is a registered trademark of the Aviva group.

AVIVA