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SALARY OR BONUS SACRIFICE

What is salary or bonus sacrifice?

It is where an employee requests his employer to reduce either their salary and/or their bonus, with the employer then putting the “sacrificed” salary or bonus into this SIPP or SSAS as a pension contribution.

So someone on a salary of say £50,000 could instruct their employer to reduce their salary to £38,000 and at the same time make a contribution to their SIPP of £12,000 (perhaps as a lump sum or as monthly contributions of £1,000).

Similarly, someone who is due to receive a bonus of say £10,000 could waive it entirely, with their employer instead making a £10,000 pension contribution.

Why might this be done?

The main reason is a saving of National Insurance contributions.

How could this be done?

Let’s look at the above examples for tax year 2012/13

Income tax and NI rates for 2012/13

The basic tax free allowance is £8,105, with 20% tax being due up to £34,370, and 40% tax on earnings above that up to £150,000, and 50% on earnings above £150,000.

The NI threshold for employers is £7,488 with the employer paying 13.8% on all earnings above that. The employee pays NI of 12% on earnings between£7,592 and £42,484, and 2% above that.

1. Salary sacrifice

We consider someone earning £50,000 who opts for a salary sacrifice of £12,000, with the employer making a £12,000 pension contribution..

Hence, with no salary sacrifice, the employee would be liable for income tax in 2012/13 of £9,884.
National Insurance would be £4,337 for the employee, giving net take home pay of £35,779

The employer would pay National Insurance of £5,867. In other words, the total employment cost for the employer is £55,867, and the net take home pay for the employee is £35,779.

With salary reduced to £38,000, the employee’s income tax bill reduces to £5,979 and their NI falls to £3,649, giving net take home pay of £28,372. The employer’s NI reduces to £4,211.

So the total employment cost for the employer reduces to £54,211, whilst the net take home pay for the employee reduces to £28,372 i.e. by £7,407. However, the employee has benefited from a pension contribution of £12,000, which has effectively cost him £7,407 in net pay. In addition, the employer has reduced its NI costs by £1,656.

The employer could in fact pay their NI savings of £1,656 as an additional pension contribution for the employer. If that is the case, there is no change to the overall employment costs for the employer, but the employee will have the benefit of a pension contribution of £13,656, which will cost them a fall in net take home pay of just £7,407 – an 84% uplift due to the savings in tax and NI!

2. Bonus sacrifice
Let's assume our employee with the £10,000 bonus is a 40% tax payer. By sacrificing the bonus their take home pay will fall by £5,800 (if they took the bonus they would pay tax of £4,000 and employee NI of £200). Their employer will save employer's NI of £1,380.

If the employer contributes the NI savings of £1,380 into the pension scheme as well, the total pension contribution will be £11,380, and will cost the employee £5,800. In this case the uplift is 96%.

Why should the employee not just pay a higher personal contribution?
The answer is that, whilst such a contribution would be eligible for tax relief at the marginal rate, there would be no saving of National Insurance.

Is it applicable only to high earners?
No: take someone on £25,000 a year. They would be liable for income tax of £3,379 and NI of £2,089, giving net take home pay of £19,532. Their employer is liable for NI of £2,417, giving total employment costs of £27,417.

If the employee sacrificed £1,000 of salary, their income tax would fall by £200 and their NI by £120 i.e. an overall reduction in take home pay of £680.

The employer would benefit from a reduction in NI of £138. If that was also paid into a pension arrangement for the employee, they would benefit from a pension contribution of £1,138 at a cost to them of £680, which is an uplift of 67% for a 20% tax payer!

Who else might benefit?
The salary sacrifice is particularly pertinent for Corporate SIPPs Those employed could ask their employer to reduce their salary and pay the reduction (plus the employer's NI savings) into their SIPP as a pension contribution.

Similarly they could forgo part or all of any bonus as a pension contribution.

Any downsides?
The reduced salary will be used for any state benefits and may affect personal borrowing limits. Professional advice must be taken.

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