# Looking after the pennies and the pounds

## An employer guide to salary exchange

ROYAL LONDON

**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.

At scheme level 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 (2025/26) **x 15%** | Employer yearly NIC saving **£11,250** |

#### 100 scheme members

| Total yearly salary payment before exchange £3,000,000 | | |
|---|---|---|
| Total salary exchanged by employees (5%) **£150,000** | Employer NIC rate (2025/26) **x 15%** | Employer yearly NIC saving **£22,500** |

#### 500 scheme members

| Total yearly salary payment before exchange £15,000,000 | | |
|---|---|---|
| Total salary exchanged by employees (5%) **£750,000** | Employer NIC rate (2025/26) **x 15%** | Employer yearly NIC saving **£112,500** |

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. Figures are rounded down to the nearest £.

## 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

| 2025/26 tax year | Before salary exchange | After salary exchange | Before salary exchange | After salary exchange |
|---|---|---|---|---|
| **Salary** | £27,000 | **£25,500** | £55,000 | **£52,155.17** |
| **Employee** | | | | |
| **Pension contribution*** | £1,080 | £0 | £2,200 | £0 |
| **Income tax payment** | £2,886 | £2,586 | £8,882 | £8,294.07 |
| **NIC** | £1,154.40 | £1,034.40 | £3,110.60 | £3,053.70 |
| **Employer** | | | | |
| **Pension contribution** | £810 | £2,535 | £1,650 | £4,921.55 |
| **NIC** | £3,300 | **£3,075** | £7,500 | **£7,073.28** |
| **Outcome** | | | | |
| **Employee take home pay** | £21,879.60 | **£21,879.60** | £40,807.40 | **£40,807.40** |
| **Total pension contributions** | £2,160 | **£2,535** | £4,400 | **£4,921.55** |
| **Cost to employer (incl. salary)** | £31,110 | **£31,110** | £64,150 | **£64,150** |

#### What this means for you

- You pay employees earning:
  - £27,000 5.56% less salary.
  - £55,000 5.17% less salary.
- Your employer pension contributions for employees earning:
  - £27,000 increase by an additional 6.39% to a total of 9.39%.
  - £55,000 increase by an additional 5.95% to a total of 8.95%.

#### What this means for your employees

- They'll exchange slightly more than 5% of their salary for an additional employer pension contribution.
- There's no change to their take home pay.
- Employees earning:
  - £27,000, benefit from an extra £375.00 pension contribution in the first year.
  - £55,000, benefit from an extra £521.55 pension contribution in the first year.

*Employee pension contribution figures are net of basic rate tax relief.

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

## 2025/26 tax year

| | Before salary exchange | After salary exchange | Before salary exchange | After salary exchange |
|---|---|---|---|---|
| **Salary** | £27,000 | **£25,650** | £55,000 | **£52,250** |
| **Employee** | | | | |
| **Pension contribution*** | £1,080 | £0 | £2,200 | £0 |
| **Income tax payment** | £2,886 | £2,616 | £8,882 | £8,332 |
| **NIC** | £1,154.40 | £1,046.40 | £3,110.60 | £3,055.60 |
| **Employer** | | | | |
| **Pension contribution** | £810 | £2,160 | £1,650 | £4,400 |
| **NIC** | £3,300 | **£3,097.50** | £7,500 | **£7,087.50** |
| **Outcome** | | | | |
| **Employee take home pay** | £21,879.60 | **£21,987.60** | £40,807.40 | **£40,862.40** |
| **Total pension contributions** | £2,160 | **£2,160** | £4,400 | **£4,400** |
| **Cost to employer (incl. salary)** | £31,110 | **£30,907.50** | £64,150 | **£63,757.50** |

### What this means for you

- You pay your employees 5% less salary.
- Pension contributions increase by 5% to a total of 8%.
- In the first year, you save:
  - £202.50 in NI contributions per employee earning £27,000.
  - £412.50 in NI contributions per employee earning £55,000.

### What this means for your employees

- They'll exchange 5% of their salary for an additional 3% employer pension contribution.
- There's no change to the total value of pension contributions paid into their plan.
- Employees earning:
  - £27,000 save £378 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 means their take home pay is slightly higher than the exchanged salary in example 1, where savings are paid into their pension plan.

*Employee pension contribution figures are net of basic rate tax relief.

## Setting up salary exchange

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

They'll 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 know as the relief at source basis.

You can choose to allow your employees 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.

Setting up a salary exchange agreement isn't necessarily complicated, but it can take a number of weeks or months to put in place. Our guide Setting up salary exchange can help you understand the steps you need to take, when to speak to your financial adviser and the support we can offer when setting up your arrangement.

## 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 earning around £200,000 or more. A salary exchange agreement could trigger the tapered annual allowance and they could incur additional annual allowance tax charges.

  If this applies to any of your employees you should speak to your financial adviser.
- 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.

## Bonus exchange

If your workplace pension is set up under a salary exchange arrangement, you can give your employees the option to exchange all or part of any contractual bonus they receive for a pension contribution.

## 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.

## Why Royal London?

At Royal London, our aim is to offer great service, with a level of support that suits both you and your employees.

We’re proud to have achieved provider of the year at the 2024 Money Marketing awards. We believe that’s because we put people at the heart of everything we do.

When you set up your workplace pension with us, you can expect to deal with real people, every step of the way.

Our employer online service will help in the day to day running of your scheme, with its range of tools and features to keep you on track with your employer duties.

Your employees will be able to keep an eye on their pension, and see the difference your employer contributions are making, with your business’s own online employee hub, and our easy to use mobile app. They’re both full of financial wellbeing guides and useful information to help them plan for their retirement.

For more information about salary exchange speak to your financial adviser or visit **employer.royallondon.com/salary-exchange**

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