



people's
pension

Employer guide to salary sacrifice

What is salary sacrifice?

If you're exploring ways to boost the value of your employees' pension pots or save your business money, salary sacrifice is a straightforward solution that's simple to set up with us.

Salary sacrifice means your employees' 'sacrifice' or exchange some of their gross salary back to you. You can then contribute this waived salary amount directly into the employees' pension pots as an employer pension contribution.

This reduces the gross wage of an employee, which means they'll save income tax (IT) and National Insurance contributions (NIC) on their earnings, and you'll also save on NIC too.

So, it's a tax-efficient way for both you and your staff to boost pension contributions and generate cost savings for your business.

If you're thinking of using salary sacrifice, you should seek specialist employment advice on how best to vary the employment contract.

Key decisions before implementing salary sacrifice

Introducing salary sacrifice will impact on numerous areas of your organisation including HR, payroll, finance and legal.

It's vital that you engage with these key stakeholders as early as possible and work through some key questions before beginning.

Businesses often underestimate how long these projects can last which is typically between 3 to 6 months.

Deciding who's joining your salary sacrifice arrangement

You have the option to select some or all of your staff for salary sacrifice. All you have to do is ensure that anyone who chooses to do this won't have their salary reduced below the National Living Wage or the National Minimum Wage.

Determine how to use your savings

Choosing whether to keep all your NIC savings, reinvest all of your NIC savings into your employees' pension plans, or do a combination of the 2 — keeping some for you and the company and giving some back to your employees — is a crucial decision when setting up your arrangement.

Reinvesting part or all of your NIC savings back into your employees' pensions may strengthen your employee benefits package and encourage scheme take-up. Alternatively, keeping all of your NIC savings provides you the opportunity to help decrease your costs and reinvest in your business.

Choosing whether to place a limit on your salary sacrifice contributions

Setting a limit can be a quick and easy method to guarantee that employees who want to sacrifice a portion of their earnings maintain their salary above the National Minimum Wage or National Living Wage.

Think about setting up salary sacrifice as your default

You have the option to set up a salary sacrifice arrangement as your pension scheme's automatic default option for all your staff. If you do, unless it's explicitly stated in their employment contract beforehand, all new employees hired by your company will automatically be included in this arrangement. If you choose not to do this, you'll need to amend your employees' contracts with an agreement letter or opt-out form, depending on whether they wish to utilise salary sacrifice or not.

Revise your employment contracts

You're legally required to amend the employment contracts of your current staff members to clearly show that a salary sacrifice agreement is in existence. This is something you may wish to incorporate into your hiring procedures and the terms of any new recruits' contracts down the road.

Before any salary is sacrificed, it's crucial to amend employee contracts since His Majesty's Revenue & Customs (HMRC) may decide not to recognise your arrangement, which might mean paying extra income tax and NIC for both you and your staff. Therefore, until the new contracts are in effect, contributions should be collected from your employees' income after taxes have been deducted.

How to make changes to employment contracts

There are several methods available to update employment contracts. These include:

- An agreement letter
- An opt-out form
- A new employment contract

Letter of agreement

An agreement letter, which may be used to set up salary sacrifice, is the most straightforward method of updating your current employment contracts. You'll need an individual letter for each employee.

The letter must be signed by you and your employee and must include the following information:

- The name of the employee
- Information on bonuses or salaries received both before and after salary sacrifice
- The start and finish dates of the salary sacrifice (if it's ongoing, no finish date is required)

You can choose to add information in the letter on how and when employees can terminate the agreement, as well as how they can opt out of it. You'll need to have a procedure in place to reduce opting in and out too frequently and the associated administrative work, whether or not you include this in the letter.

You can include in the letter how an employee can opt back into the agreement if they have already opted out but wish to change their mind at a later date, such as via email or in writing.

Opt-out form

As an alternative, you may document requests from staff who would prefer not to be part of the salary sacrifice agreement by using an opt-out form. This should be just as detailed as an agreement letter.



Letting your staff choose

It's still up to your employees to determine whether or not to join your salary sacrifice arrangement, regardless of whether you've chosen it as your default for all of your staff. Additionally, even though this flexibility may increase your administrative costs, you can offer them the choice to contribute their own NIC savings to their take-home pay or invest them in their pension plan.

Some employees may have decided they no longer wish to be a part of the salary sacrifice agreement due to a change in their personal circumstances, such as a divorce or a change in their financial situation. It's important that you have a well-defined procedure for handling employees who choose to participate in or withdraw from the arrangement. Following their opt-out of salary sacrifice, if they're not completely withdrawing from your workplace pension altogether, they'll continue to make pension payments, but only on a relief-at-source basis following the deduction of taxes. You may still set up a salary sacrifice with us if you operate on a net-pay basis, but we recommend that you talk to your business manager at People's Pension first.

Make sure your employees understand the terms of the salary-sacrifice agreement

You can choose to allow your staff to trade in their salary alone or to include any potential contractual bonuses you choose to provide in the salary sacrifice arrangement. The structure of the arrangement won't alter, but you'll need to provide your staff with a different letter about contractual bonuses.

You can find more information on our salary sacrifice webpage:
peoplespension.co.uk/employers/salary-sacrifice

Work out the sacrifice amounts for employee salaries

You need to check your payroll system to see what assistance it can provide in managing the salary sacrifice, including figuring out take-home pay, pension contributions, and opt-out refunds. You'll need to determine how to compute this and whether additional resources are needed if your payroll system can't manage it.

Make changes to your employees' payslips

Regardless of whether it's a salary or bonus payment, employee payslips need to show what's going on and be updated to reflect a salary sacrifice contribution. HMRC won't acknowledge it as a salary sacrifice agreement if you don't amend the payslips to reflect this information, which might cause administrative problems in the future. You can confirm that the arrangement information has been entered accurately by looking at the payslip.

Understand your legal responsibilities

Make sure you have all the necessary arrangements in place before setting up a salary sacrifice arrangement. This involves modifying the employment contracts of your employees to comply with regulatory requirements. Since this concerns employment law, you should consult with a legal professional. This guide's content is based on our comprehension of the most recent laws and HMRC regulations. Changes may be made to these in the future.

How much can you save?

The amount saved will depend on the level of salary being sacrificed per employee. Significant savings can be generated for you and your employees. Collectively, across a large workforce, an employer can achieve a substantial saving in NIC.

Employer savings

The figures in the following example are based on 2025/26 tax year rates. They assume an annual average pensionable pay of £30,000 for each employee, with each employee contributing 5% into their pension:

Scheme members	1	50	500
Salary sacrificed by the employee	£1,500	£75,000	£750,000
Employer NIC rate (2025/26)	15%	15%	15%
Employer's yearly NIC savings	£225	£11,250	£112,500

The savings generated can be reinvested into the business, allocated to employees to enhance their pension pots (thereby improving retirement outcomes), or a combination of these options.

Employee savings

The calculations below compare the outcomes of an employee contributing to their pension through relief at source, net pay and salary sacrifice arrangements in the 2025/26 tax year. In this example, the employee earns pensionable pay of £30,000 a year and contributes 5% into their pension:

	Relief at source	Net pay	Salary sacrifice
Gross annual salary	£30,000	£30,000	£30,000
Employee pension contribution	N/A	£1,500 Deducted before IT and after NIC	£1,500 Deducted before IT and NIC
Total taxable salary	£17,430	£15,930	£15,930
Income tax (IT) paid	£3,486	£3,186	£3,186
Employee NIC	£1,394	£1,394	£1,274
Employee pension contribution	£1,200 Deducted after IT and NIC (net of 20% tax relief)	N/A	N/A
Net annual salary	£23,920	£23,920	£24,040

While the value of the annual pension contribution remains unchanged in these examples, deducting them before calculating income tax and NIC via salary sacrifice reduces the tax and NIC paid. As a result, the employee's take-home pay increases by £120 a year (or £10 a month). This additional money can be added to their pension pot as a tax-efficient way to boost their retirement savings.

Employee communication and support

It's important to communicate with your employees so they fully understand the benefits of salary sacrifice, how it works, and any potential impacts on their take-home pay and statutory benefits. (For more information on how your employees' statutory rights might be affected, see the 'Things to consider' section below.)

Review and monitoring

Regularly reviewing your salary sacrifice arrangement ensures it continues to meet your company's needs and those of your employees. Monitoring the arrangement and keeping updated with any changes in law around tax and pension regulations is essential to remaining compliant and maximising benefits.

Setting up salary sacrifice with People's Pension

It's straightforward to set up salary sacrifice with us. Our team will guide you through the process, ensuring a smooth setup.

Find out more

If you're interested in benefiting from salary sacrifice, you can check out our dedicated salary sacrifice webpage — peoplespension.co.uk/employers/salary-sacrifice — for more information.

If you need support setting up a salary sacrifice arrangement with us and don't know where to start, our handy step-by-step guide is here to help: peoplespension.co.uk/workergroup

Things to consider

- Changing your employees' gross salaries can impact their other benefits, such as salary bonuses and statutory benefits like maternity or paternity entitlement.
 - Staff payslips must show the amount of salary sacrificed. It's important to check with your payroll provider to see if your software can record the change.
 - Your employees' tax situation may change in the future, which could change their level of salary sacrifice savings.
 - Previously, utilising salary sacrifice could affect the amount participating employees could borrow for a loan or mortgage.
- However, currently, most lenders calculate what they'll loan based on an applicant's gross salary – before the salary sacrifice is deducted.
- Salary sacrifice may not be suitable for employees with a tapered annual allowance – individuals earning over £260,000 – as it could lead to them paying additional tax charges.
 - If any of your staff are at risk of redundancy, you have the option to sacrifice part of their redundancy payment too.

Quick salary sacrifice Q&As

Q: How much will it cost my company to set up salary sacrifice with us?

A: Nothing, it's completely free to set up and implement.

Q: How long does it take to get set up?

A: Implementing salary sacrifice typically takes 3 to 6 months to complete. You can take advantage of salary sacrifice as soon as you've received permission from your staff, updated your payroll, and set up your 'Salary sacrifice' worker group in your Online Services account. Applicable employees will see their salary change and/or pension contributions increase on the next monthly payroll.

Q: Will I need to update my payroll processes?

A: Yes, you should contact your payroll provider to see if they can facilitate salary sacrifice for your pension arrangements.

Q: Is it hard to manage?

A: Once you set up your payroll and Online Services account, it's straightforward to run and administer. However, you may need to make changes to both if more of your team wish to sign up for salary sacrifice at a later date. Additionally, it's beneficial to keep up with any changes in pension or tax law to make sure your salary sacrifice arrangement is still right for your company and your employees.

Q: Can pension contributions or take-home pay be increased through salary sacrifice?

A: Yes, an employee can increase their take-home pay by lowering their NIC through salary sacrifice. Effectively, they're earning a lower salary, but both your company and the employee pay lower NIC, which can result in higher take-home pay for the employee.

These NIC and income tax savings can be used to increase their pension contributions.

Q: If I operate a net-pay arrangement, can I utilise salary sacrifice?

A: Yes, you can, but we recommend speaking with your business manager at People's Pension before proceeding.

Q: How does salary sacrifice affect higher and additional-rate taxpayers who can claim additional tax relief?

A: Salary sacrifice is classified as an employer pension contribution; therefore higher and additional-rate taxpayers don't need to seek higher and additional tax relief through their self-assessment tax returns. They now get their tax relief immediately (on the salary sacrificed) and therefore no longer need to claim it through self-assessment.

Q: How can any savings on employer NIC be used?

A: You can use the employer NIC savings to increase pension contributions, provide other employee benefits, or keep the savings to reinvest in your business.

Q: Can salary sacrifice be set up on your current pension?

A: Yes, you can set up salary sacrifice for your existing pension.

Q: Is it necessary to notify HMRC regarding salary sacrifice agreements?

A: No, HMRC doesn't need to be notified about your salary sacrifice agreements. Salary sacrifice involves changing an employee's contract to benefit from tax savings and is an agreement between you and applicable employees.

Setting up a 'Salary sacrifice' worker group in your Online Services account and updating your payroll are all you need to do, but employers have the option of consulting HMRC to ensure the correct tax treatment of such arrangements.

Q: Is it possible to change a salary sacrifice arrangement?

A: Yes, it's possible to change a salary sacrifice arrangement. However, to guarantee a smooth transition, it's recommended that you speak with your HR department and a financial adviser.

Q: Can other state benefits be reduced by salary sacrifice?

A: Yes, it can affect other state benefits, such as maternity allowance. More information about the potential effect on state benefits can be found on HMRC's website: gov.uk/guidance/salary-sacrifice-and-the-effects-on-pay

Q: Is it possible to cancel a salary sacrifice agreement whenever you want?

A: Yes, you can end a salary sacrifice arrangement whenever you want, but you'll need to change the impacted employees' contracts when you do.

Q: Can an employee sacrifice all their salary?

A: No, employees cannot sacrifice all their salary as it would reduce their salary below the National Minimum Wage or National Living Wage.

Q: Is HMRC able to provide advice about how to draft a salary sacrifice agreement?

A: No, any letter of agreement, opt-out form, or new contract is an agreement between you and your employees, so HMRC won't get involved with this. If you need help creating a salary sacrifice agreement letter, you can consult an employment law specialist.

Q: What happens if an employee utilising salary sacrifice goes away on long-term illness or parental leave?

A: If you're still paying the employee on parental or long-term sickness leave, you'll have to continue making salary sacrifice payments, unless this is stipulated in the letter of agreement or contract letter.

Q: When salary sacrifice is being used for an auto-enrolment scheme, how can I find out if the minimum contribution levels have been reached?

A: The post-sacrifice wage is what you must use to determine if the minimum payments have been met.

Q: If an employee wishes to opt out of salary sacrifice, who do they need to contact?

A: They'll need to contact you (their employer) to opt out of the salary sacrifice agreement.

However, if they wish to opt out of your workplace pension (and by default, the salary sacrifice arrangement), they'll need to get in touch with us through our customer support hub.

Q: To set up salary sacrifice, do we need to change the contract with People's Pension?

A: No, you don't need to change your contract with us, but it's essential that you update your worker groups on your payroll. If you set up a salary sacrifice arrangement, the agreement is between you and applicable employees, not People's Pension.

For help updating your worker groups, please see our step-by-step guide: peoplespension.co.uk/workergroup

Q: Does People's Pension communicate with members when they switch to salary sacrifice?

A: No, as the arrangement is between you and your employees, it's your responsibility to notify your staff about the change.

Considering salary sacrifice?

Employers using salary sacrifice should take specialist employment advice on how best to vary the employment contract.

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