Salary Sacrifice – A Guide

What is salary sacrifice?

Salary sacrifice is an agreement between an employee and an employer in which gross salary is reduced in exchange for a non-cash benefit. As the amount is taken before tax and National Insurance, this can often lead to a reduction in tax paid. This allows employees to access items that may be too costly to purchase upfront. Offering this as an employer can be a benefit to attract and retain talent as part of a competitive benefits package.

What salary sacrifice schemes are there?

Examples of some salary sacrifice schemes are:

- Cycle to work scheme – This encourages people to adopt a greener and healthier commuting option to work. Under the scheme, the employee can purchase a bike and supporting equipment through salary sacrifice.

- Electric vehicle schemes – Employees can again make more sustainable choices and lease an electric car at affordable prices.

- Pensions – This is the most common salary sacrifice made in the UK with people making pension contributions. The average pension contribution in the UK is 8% of an employee's earnings.

- Gym membership – Employees may be able to sacrifice part of their salary to cover gym membership costs.

How does the salary sacrifice scheme normally work?

There are several steps when setting up a salary sacrifice agreement.

- An agreement must be made between the employer and the employee – This makes sure that both parties are happy with the benefit they will receive in exchange for a reduction in salary.

- Is the employee eligible – Each salary sacrifice scheme will have its own requirements and eligibility criteria. It is also important to review that the employee will not fall below minimum wage at any point during the length of the agreement.

- Length of agreement – This can be agreed for a wide range of time depending on the benefit that is being received. Both parties must agree on the length of the agreement.

- Salary reduction and receiving benefit – The agreed reduction is taken from the gross salary (before tax and National Insurance is calculated) and the employee will be able to access the benefit.

What else is there to consider?

- As gross pay is reduced, it may be difficult to prove income when seeking, for example, mortgages or loans. This can also impact other benefits that are calculated based on salary such as bonuses.

- Should circumstances change, flexibility may also be an issue if the agreements are binding for a set period.

- As an employer, there is an increase in administrative tasks to ensure that all conditions of the agreement are met, and that the salary remains above minimum wage.

If you have any queries, please contact your local AMR branch.