

A sacrifice too far?

An exploration of the impact of reducing or removing
salary sacrifice arrangements for pensions

November 2025

Introduction

Earlier this year, research into salary sacrifice¹, commissioned by HMRC, led to some speculation that the government may seek to make savings by abolishing or reforming salary sacrifice for pension contributions. In the run-up to the November 2025 Budget, such speculation has inevitably increased.

The Society of Pension Professionals (SPP) is therefore keen to explore and explain what salary sacrifice for pensions is, why it matters, how it is used and by whom, and what the implications would be if government were to impose restrictions or abolish this longstanding arrangement.

What is pension salary sacrifice?

Salary sacrifice for pensions (also known as salary exchange) is an optional arrangement where an employee gives up a portion of their salary in return for their employer paying an equivalent amount into their pension. Whilst they are funded by the employee, they are treated as employer pension contributions for income tax and National Insurance purposes.

This means that pension salary sacrifice normally leads to savings in both the employee and employer National Insurance Contributions (NICs). This is because employer pension contributions are not subject to NICs, whereas employee pension contributions are made after the deduction of NICs.

Pension salary sacrifice is therefore an important element in incentivising pension saving. As well as increasing the tax efficiency of pension contributions, it encourages employer engagement and the promotion of pension saving, and it can lead to a direct increase in the amount saved.

Who uses salary sacrifice?

Around a third of private sector employees make use of salary sacrifice arrangements, and almost 10% of public sector workers do so too². This means that they are a well established and well-functioning feature of the UK pensions landscape.



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¹ Understanding the attitudes and behaviours of employers towards salary sacrifice for pensions, May 2025: <https://www.gov.uk/government/publications/understanding-the-attitudes-and-behaviours-of-employers-towards-salary-sacrifice-for-pensions>

² Ibid

How does salary sacrifice for pensions work?

1. The employee agrees to give up part of their gross salary.
2. The employer pays the equivalent amount (or more) directly into their pension scheme.
3. The employee saves on NICs, which means higher contributions could potentially be paid and still result in the same net take home pay (see example 2 below).

(The Employee also saves on income tax, although this is the case regardless of whether the contribution is paid via salary sacrifice).

4. The employer also saves on NICs and may pass part or all of this saving back to their employee's pension through a higher pension contribution.

Example 1: Simple illustration of salary sacrifice

	No salary sacrifice	With salary sacrifice
Gross salary prior to employee pension / salary sacrifice	£40,000	£40,000
Employee pension contribution (5%)	£2,000	£2,000
Earnings subject to NICs	£40,000	£38,000
Employee NICs (8% on earnings above £12,584)	£2,193	£2,033
Employer NICs (15% on earnings above £4,992)	£5,251	£4,951
Saving in NICs - employee		£160
Saving in NICs - employer		£300

The example above assumes a consistent contribution of £2,000 pa, which results in higher take home pay for the employee and cost savings for the employer. However, many employers share their NIC savings with their employees, and salary sacrifice also allows employees to pay higher pension contributions for the same net pay.

The following example assumes that half of the employer NIC saving (i.e. 7.5% of the salary sacrifice contribution) is passed to the employee through a higher pension contribution.

Example 2: Higher pension contribution using salary sacrifice

	No salary sacrifice	With salary sacrifice
Gross salary prior to employee pension / salary sacrifice	£40,000	£40,000
Employee pension contribution	£2,000	£2,174
Employer top-up from NIC saving (7.5% of contribution)	£0	£163
Total pension contribution	£2,000	£2,337
Earnings subject to NICs	£40,000	£37,826
Employee NICs (8% on earnings above £12,584)	£2,193	£2,019
Taxable employee pay after NICs	£35,807	£35,807

So, in this example where the employer shares the NICs saving, the pension contribution is increased by £337 with the same take home pay. This is an increase of 17% compared with the pension contribution without salary sacrifice.

Additional considerations and complexities

For pension salary sacrifice to be effective, a formal amendment to an employee's contract of employment is needed to confirm the arrangements.

Under the agreement, the employee's salary is reduced, and this may impact mortgage applications and certain benefit payments, such as statutory maternity pay or redundancy benefits. It may also mean lower life insurance cover, where this is based on a multiple of salary, depending on how salary is defined for this purpose.

Payment of contributions via salary sacrifice may also affect an employee's right to a refund of their own contributions if they leave shortly after commencing their employment.

The potential benefits of pension salary sacrifice are reduced for very low earners, with no employee NICs saving for those earning less than £12,584 pa. The threshold for employer NICs was reduced in 2025, though, so the employer savings apply for earnings above £4,992 pa. In any event, salary cannot be sacrificed below the minimum wage. In practical terms, this means that pension salary sacrifice is not feasible for those with full-time equivalent earnings of around £20,000-£25,000 pa, depending on the hours worked.

Cost to HM Treasury

Salary sacrifice arrangements clearly have a cost to the Exchequer, and this led to HMRC's decision in 2017 to remove the National Insurance (and income tax) advantages of salary sacrifice for the majority of benefits-in-kind, excluding childcare, Cycle to Work schemes, and ultra-low emission cars.

However, pension contributions were excluded from the 2017 changes and continue to receive favourable tax treatment, because there is widespread recognition that salary sacrifice is a positive investment that incentivises pension saving.

HMRC figures suggest that the total cost of National Insurance relief on pension contributions was £24.0bn for 2023/24. Of this, £4.1bn relates to pension salary sacrifice (£1.2bn employee and £2.9bn employer)³.



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Treatment of salary sacrifice versus regular employee contributions

Pension salary sacrifice has significant potential benefits. It incentivises pension saving through greater tax efficiency, and it can directly increase the amount employees save for retirement. The potential savings in employer NICs also encourages the vital role employers play in engaging with their employees regarding retirement savings and promoting good quality pension saving vehicles.

However, there is an obvious anomaly with the treatment of personal employee pension contributions paid outside salary sacrifice arrangements, which do not receive the same NICs relief, and salary sacrifice arrangements are not available to everyone. Indeed, the majority of employees do not make use of pension salary sacrifice because only 39% of UK employers say they offer such arrangements to all employees⁴.

Establishing a pension salary sacrifice arrangement requires proper processes and documentation to be put in place. The requirements are not onerous, although some professional advice may be needed, and the requirements may mean that pension salary sacrifice is not an option considered by some smaller employers.

The interaction with the minimum wage is also a factor. If an employer has a reasonable number of employees caught by the minimum wage restriction, pensions salary sacrifice could lead to segregation of the workforce and perceived inequity. This may lead some employers to decide that pension salary sacrifice arrangements are unsuitable, even for those who would be eligible.

³ Private pension statistics, 31 July 2025:
<https://www.gov.uk/government/statistics/personal-and-stakeholder-pensions-statistics>

⁴ Nest Insights, 2022:
https://www.nestinsight.org.uk/wp-content/uploads/2022/10/Employer-pension-contributions-in-the-UK.pdf?utm_source=chatgpt.com

How removing (or reducing) salary sacrifice might work in practice

HMRC commissioned research to understand the attitudes and behaviours of employers towards salary sacrifice for pensions⁵. This confirmed that employers are generally very supportive of the arrangement and believe that changes would cause confusion, reduce benefits to employees, and disincentivise pension savings.

The research put forward three potential possible scenarios for restricting salary sacrifice:

- 1) removing the NICs exemption for employers and employees
- 2) removing the NICs exemptions for both employers and employees, as well as removing the income tax exemption for employees
- 3) removing the NICs exemption but only on salary sacrificed above a £2,000 per year threshold

Scenario 2 would effectively mean scrapping pension salary sacrifice arrangements altogether, given that pension contributions outside of salary sacrifice are exempt from income tax.

The scenarios are based on an employee on £35,000 per annum, who sacrifices 5% (£1,750) of their salary and in return the employer contributes the same amount (£1,750) into the employee's pension scheme. The employer also contributes a further 3% (£1,050) outside of the salary sacrifice arrangement.

Scenario 1 would mean an additional NICs cost of £242 for the employer and £210 for the employee.

Scenario 3 would result in no additional NICs cost for an employee on £35,000 but if the employee opted to contribute more than £2,000 then they would face increased NICs costs. There would also be additional administrative costs for employers in managing scenario 3.

Employers flagged that in all 3 scenarios, employee morale was likely to be negatively affected.



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Implications of removing or reducing salary sacrifice in the UK

Impact on employees

Changing salary sacrifice arrangements would lead to a reduction in take home pay for any employees currently making use of these arrangements unless pension contributions are reduced to allow for the NICs increase. The impact would be greater for those earning less than £50,284 pa, for whom employee NICs are 8%. For those earning above £50,284 pa, employee NICs are 2%, so the impact is less. This impact would be significantly mitigated if any changes only applied to salary sacrifice arrangements entered into or modified on or after the date of any announcement.

It would also lead to reduced pension contributions and poorer retirement outcomes where the employer is sharing some of their NICs saving with their employees, or if employers seek to mitigate their increased costs by reducing pension contributions more generally.

Impact on employers

Scrapping salary sacrifice would represent a sizeable cost to employers.

This would breach the Chancellor's public commitment not to impose any additional costs on employers, effectively amounting to another increase on employer NICs.

Employers are likely to seek to recover these increased costs, potentially through reduced recruitment, damaging economic growth. Or they might seek to recover these costs from their employees, through lower pay increases, or a reduction in pension contributions.

Other impacts

If salary sacrifice were abolished in the UK, employers would likely seek alternative ways to restructure reward packages to maintain tax efficiency, retain staff, and manage costs. For example, it may be more attractive for employers to offer new employees a lower starting salary, but with a non-contributory pension scheme. While some of the tax advantages would be lost, creative restructuring and tax planning is likely to occur.

Another key impact, perhaps the most important, would be reduced pension saving. Given the government has recently revived the Pensions Commission to tackle the serious problem of pensions adequacy, with DWP confirming over 15 million people are not saving enough for their retirement, scrapping salary sacrifice arrangements would undoubtedly make this challenge greater.

⁵ Understanding the attitudes and behaviours of employers towards salary sacrifice for pensions, May 2025: <https://www.gov.uk/government/publications/understanding-the-attitudes-and-behaviours-of-employers-towards-salary-sacrifice-for-pensions>

⁶ BBC, Reeves tells firms no more tax rises as she defends Budget, November 2024: <https://www.bbc.co.uk/news/articles/c33ek51rx57o>

Acknowledgements:

The SPP is grateful to all its members for their contribution towards this publication, particularly Steve Hitchiner, Phil Warner, Richard Wyatt, John Wilson and Dale Critchley.

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Founded in 1958 as the Society of Pension Consultants, today SPP is the representative body for a wide range of providers of pensions advice and services to schemes, trustees and employers. These include actuaries, accountants, lawyers, investment managers, administrators, professional trustees, covenant assessors, consultants and pension specialists.

Thousands of individuals and pension funds use the services of one or more of the SPP's members, including the overwhelming majority of the 500 largest UK pension funds.

The SPP seeks to harness the expertise of its 85 corporate members - who collectively employ over 15,000 pension professionals - to deliver a positive impact for savers, the pensions industry and its stakeholders including policymakers and regulators.

Further information

If you have any queries or require any further information about this discussion paper, please contact the SPP's Director of Policy & PR, Phil Hall phil.hall@the-spp.co.uk or telephone 07392 310264

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