SCOTTISH WIDOWS

# Could I benefit from Salary Exchange?

Salary Exchange (sometimes referred to as Salary Sacrifice) is an arrangement where you can exchange part of your earnings or bonus in return for an employer pension contribution.

As the gross salary is being 'exchanged' rather than paid, you won't pay National Insurance Contributions (NICs) on the amount exchanged, giving you the potential to save money.

The exchanged amount can then be paid into your pension plan, which means that the money you've exchanged will be shown as an employer contribution in your benefit statements.

## How does it happen?

Every Scottish Widows workplace pension is tailored to each company individually. However, in general, there are three steps to Salary Exchange:

1. **Offer** – The employer makes an offer of Salary Exchange to any employees who may benefit from it.
2. **Acceptance** – The employee agrees to salary exchange and the amount by which their salary will be reduced.
3. **Pension payment** – The employee's gross salary is reduced by the agreed amount and this money can then be paid into their pension plan by their employer.

# What difference will it make to my take home pay?

Opting in to Salary Exchange could mean you take home more pay than if you contributed directly to your pension. Alternatively, it could mean the same take-home pay and a higher pension contribution.

The following example shows how contributions are paid through Salary Exchange and how NI savings are made if the pension contribution stays the same. The figures are based on:

Annual gross salary of **£35,000**

Tax rate of **20%**

Pension contributions of **5%**

| | Before salary exchange | After salary exchange |
|---|---|---|
| Annual Salary (Gross) | £35,000 | £33,250 |
| Tax You Pay | £4,486 | £4,136 |
| National Insurance | £1,794 | £1,654 |
| Net pay after tax and NI | £27,320 | £27, 460 |
| Your pension contribution | £1,750 | nil as amount has been exchanged |
| Employer Contribution | £1,050 | £2,800 |
| **Total Pension Contribution** | **£2,800** | **£2,800** |
| **Take home pay** | **£27,320** | **£27,460** |

As you can see, this example shows that the employee's take home pay is £140 higher a year as a result of Salary Exchange. Please note that some schemes use the NI savings to boost the pension contribution rather than the take home pay.

# How Bonus Exchange works

**The following is an example of Salary Exchange based on an employee receiving a gross salary of £35,000 and a bonus of £4,000 and 'exchanging' the bonus for a contribution into their pension.**

Amount paid to their pension if they used their net bonus to pay a personal contribution: **£3,600**

Amount the employer would pay directly into their pension instead: **£4,000**

The employer's national insurance savings may also be paid into their pension: **£600**

Potential Total contribution to their pension: **£4,600**

# Frequently Asked Questions

### What is 'reference salary' and why is it important?

Reference salary is the amount you would have been paid before entering into salary exchange. Your reference salary will be held by your employer, you should also keep a note of it. It is important as it helps ensure you do not lose out on any benefits that are salary related.

### Does Salary Exchange impact lending based on pay?

Salary exchange results in a real reduction in the employee's gross salary, therefore anything calculated with reference to salary can be affected. Many lenders however, may be prepared to use the original 'reference salary' when calculating the amount they are prepared to lend.

### Does Salary Exchange affect death in service benefit?

If the provider calculates the death in service cover with reference to the reduced gross salary then, yes, it will be affected. If the original 'reference salary' is used instead then the death in service amount will be unaffected.

### How does Salary Exchange impact statutory benefits?

If the amount of statutory benefit available is calculated with reference to earnings it will use the gross salary after it has been reduced by salary exchange.

### What happens if I am a low earner?

Salary exchange is unlikely to be beneficial for low earners. Those earning below the current income tax personal allowance of £12,570 should be better off making contributions directly to a personal pension, which will give them 20% income tax relief on their contributions. And those earning below the primary threshold (also £12,570 annually) do not pay national insurance contributions and so won't see any increase in their take home pay or pension contributions as a result of salary exchange.

### How does salary exchange work if my hourly rate is near the minimum wage?

Salary exchange must not result in your hourly rate of pay being reduced below the national minimum/living wage. If this would apply your employer should restrict the offer of salary exchange accordingly to ensure, that after salary exchange, you are still paid the minimum wage or more.

## Is it right for me?

If it's right for you, it could increase your pension contributions or take-home pay. Low earners, however, may not benefit from salary exchange and some could even be worse off. Speak to your employer or financial adviser to see if it fits your finances and retirement plans.

Some people prefer not to pay towards their pension by Salary Exchange because it means they will receive a lower pre-tax salary, which might have a knock-on effect on anything calculated with reference to salary such as state benefits or personal lending.

# Find out more

If you want further information about how salary exchange works and how this could affect other benefits you may be entitled to, you can visit:

Money Helper
**(www.moneyhelper.org.uk)**

or speak to a financial adviser
(you can find one by visiting **www.unbiased.co.uk**)

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