SAVE MORE AND REDUCE TAX (SMART)

Your guide to using salary exchange (also known as salary sacrifice) for your workplace pension contributions

TAX YEAR 2019-2020

LORICA

a healthy relationship with money

Would you benefit from SMART pension contributions?

SMART stands for 'save more and reduce tax' and is another name for pensions *salary sacrifice* or *salary exchange*. Your employer and/or pension provider may use any of these terms; they all mean the same thing. You may also be familiar with salary sacrifice in relation to other employee benefits, such as company cars, work-related training or cycle to work schemes.

For simplicity and consistency, we use the term SMART throughout the rest of this guide. And, for many people, making pension contributions in this way is indeed financially smart.

SMART is a tax-efficient way of making personal contributions to your workplace pension scheme.

Traditional employee pension contributions already benefit from tax relief at your highest marginal rate. However, with SMART, you **also benefit from National Insurance Contribution (NIC) savings**. This is because SMART pension contributions are deducted from your gross salary, before income tax and NICs are calculated.

Two key benefits of SMART contributions:

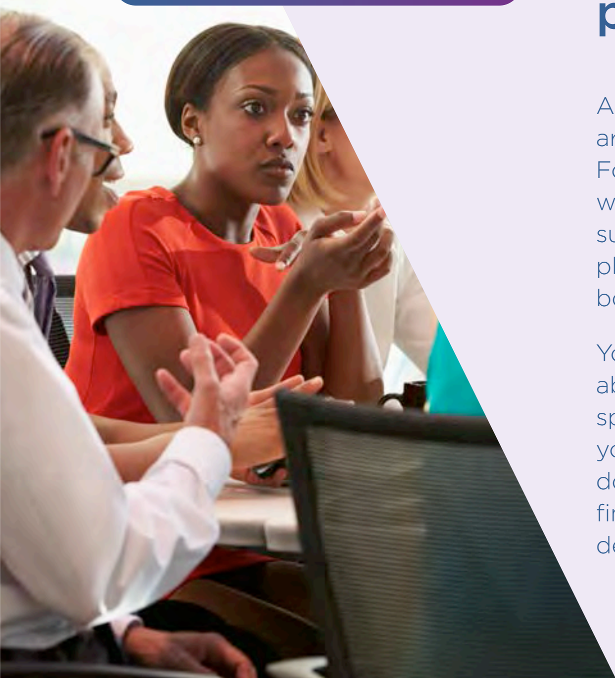
1. Your salary is reduced by your SMART contribution, so your **NICs are lower** and your **take-home pay is higher**
2. You benefit from **full, immediate income tax relief** - no need for higher- and additional-rate taxpayers to reclaim separately

Your employer's SMART scheme

This guide is intended to provide a general overview of how SMART contributions work, and the benefits of making pension payments in this way.

Individual SMART contracts vary, and you should refer to the documentation provided by your employer for the details of your specific scheme.

SMART is beneficial for most people, but is not suitable for everyone. See the frequently asked questions (FAQs) on page 8.



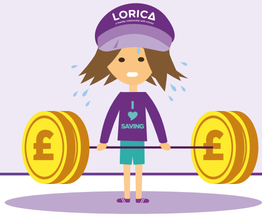
CONTENTS

Your workplace pension scheme

All figures shown in this guide are for example purposes only. For more details on your specific workplace pension arrangements, such as your contribution rates, please refer to your scheme booklet or website.

Your HR or payroll team will be able to confirm the details of your specific SMART arrangement. If you have any other queries, please don't hesitate to contact the Lorica financial wellbeing team using the details on page 12.

The SMART journey



You decide...

How much you want to save in your workplace pension (subject to any minimum contribution levels required under your employer's scheme).

You agree...

To give up this amount from your **gross** salary every week or month (agreement normally subject to a minimum period of 12 months).

Your employer pays...

Your SMART pension contribution into your workplace pension scheme, along with any contribution they're making on your behalf.

You keep...

Your original (pre-SMART) salary as your 'reference' salary for the purposes of calculating other benefits or applying for credit.

You benefit from...

NIC savings, higher take-home pay, **and** all the usual workplace pension benefits, such as income tax relief and employer contributions.

Definitions...

Gross salary:	your pay before income tax & NICs are deducted
Net salary:	your take-home pay
Reference salary:	your gross salary **before** your SMART pension contribution, used to calculate other benefits etc

Pensions annual allowance (AA)

Providing you do not exceed certain limits, pension contributions benefit from tax relief at your highest marginal rate. This applies to both traditional employee contributions and SMART contributions.

The total amount of tax-relievable pension contributions you can make each year is known as the **annual allowance (AA)**. For most people, the AA is the lower of **£40,000 or 100% of your earnings** (see box for exceptions ➔).

The AA applies to all pension contributions - including any made by your employer, or another third party, on your behalf.

Income tax rates and thresholds (England)

Personal allowance (PA)*	£12,500*
Basic rate (20%)	up to £37,500
Higher rate (40%)	£37,501 - £150,000
Additional rate (45%)	over £150,000

2019/2020 tax year

*The amount you can earn each year before you are subject to income tax. The normal PA is reduced by £1 for every £2 of earnings above £100,000, so it is lost altogether once earnings exceed £125,000 a year.

Because SMART contributions reduce your salary, you benefit from NIC, as well as income tax, savings. The exact income tax and NIC savings you make through SMART will depend on your individual circumstances.

Reduced AAs...

Some people's AA is less than the standard £40,000:

High earners

The AA is gradually tapered down for people who have a total annual 'adjusted income' (from all sources) of £150,000 or more. It falls by £1 for every £2 of income above this threshold, to a minimum of **£10,000** (for those with annual income of £210,000+). **Adjusted income includes pension contributions made by you and/or your employer.**

Already accessed pension

People aged 55+, who have already started to access their defined contribution (DC) pension savings, have a permanently reduced AA of **£4,000**. This is known as the **money purchase annual allowance (MPAA)**.

SMART savings for basic-rate taxpayers

Example based on an employee earning £25,000 a year, making a 5% pension contribution.

This page provides an example of the savings you could make through SMART contributions if you're a basic-rate taxpayer. The table compares a monthly SMART payment with the same employee pension contribution made in the traditional way (i.e. your net contribution is deducted from your net pay).

Tax rates and thresholds used in the examples here and on page 7 are those applicable in England for the 2019/20 tax year. Different rates and thresholds may apply in Wales, Scotland or Northern Ireland.

	Each year	Each month
Gross/reference salary	**£25,000**	**£2,083.33**
Gross pension contribution	**£1,250**	**£104.17**

Traditional	**< MONTHLY EXAMPLE >**	**SMART**
-	**< SMART contribution >**	£104.17
£2,083.33	**< gross monthly pay >**	£1,979.17
£208.33	**< income tax >**	£187.50
£163.68	**< employee NICs >**	£151.18
£83.33	**< net pension contribution >**	-
£20.84	**< basic-rate tax relief added >**	-

total saved in pension

£104.17

Take-home pay:

£1,627.99

Pension contribution net cost to you:

£83.33

Take-home pay:

£1,640.49

Pension contribution net cost to you:

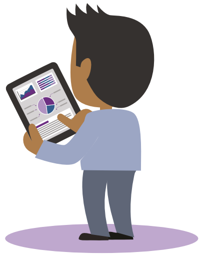
£70.83

SMART savings for higher-rate taxpayers

Example based on an employee earning £60,000 a year, making a 5% pension contribution.

This page provides an example of the savings you could make through SMART contributions if you're a higher-rate taxpayer.

The table compares a monthly SMART payment with the same employee pension contribution made in the traditional way (i.e. your net contribution is deducted from your net pay, and you reclaim your higher- or additional-rate tax relief separately via your tax return).



	Each year	Each month
Gross/reference salary	£60,000	£5,000
Gross pension contribution	£3,000	£250.00

Traditional	< MONTHLY EXAMPLE >	SMART
-	< SMART contribution >	£250.00
£5,000.00	< gross monthly pay >	£4,750.00
£958.33	< income tax >	£858.33
£430.35	< employee NICs >	£425.35
£200.00	< net pension contribution >	-
£50.00	< basic-rate tax relief added >	-
£50.00	< higher-rate relief reclaimed >	-

total saved in pension

£250.00

Traditional

Take-home pay:

£3,411.32

Pension contribution net cost to you*:

£150.00

*After higher-rate tax reclaimed

SMART

Take-home pay:

£3,466.32

Pension contribution net cost to you*:

£145.00

*No need for separate reclaim

Frequently asked questions (FAQs)

1. Is SMART compulsory?

No. Even if SMART is the usual contribution method at your employer, you shouldn't be using it if it's not suitable for you (see question 2) or if you don't want to. A SMART scheme is a contractual arrangement that requires your consent. You can choose not to participate in your employer's SMART scheme and to make pension contributions in the traditional way instead.

2. Is SMART suitable for everyone?

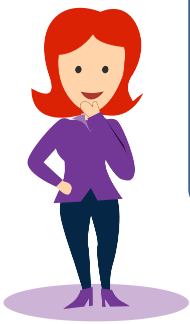
No. Some people don't benefit from SMART.

SMART is unsuitable if you earn the National Living Wage (NLW) or, if you are under 25, the National Minimum Wage (NMW), or an amount just above these levels. **It is not legal to use SMART if doing so reduces your salary to below the NLW or NMW.**

If you work part time and don't earn enough to pay NICs, then you won't make any additional savings via SMART.

If you are working past state pension age you no longer have to pay NICs, so, again, can't make NIC savings. However, if you're a higher- or additional-rate taxpayer, SMART contributions allow you to avoid the hassle of claiming the extra tax relief you are due from HMRC. Plus, your employer still has to pay NICs and they may have decided to share some or all of their savings as an additional pension contribution.

If you earn less than £12,500 a year, and so are a non-taxpayer, SMART is not advantageous. Traditional (net-from-net-pay) employee contributions provide basic-rate tax relief even to non-taxpayers. The NIC savings made through SMART would be less than the tax relief you would forfeit; so SMART is not for you.



If you have any doubts about whether SMART is suitable for you, please check with your HR or payroll team.

3. How much do I pay in NICs?

NIC rates are tiered depending on how much you earn, as shown in the table below:

Weekly earnings up to £166	0%
Weekly earnings between £166 and £962	12%
Weekly earnings over £962	2%

4. Does my employer make any savings from SMART?

Yes. Employers make a NIC saving of 13.8% on the amount of salary you choose to exchange for a SMART contribution.

Your employer may choose to retain this saving, use it to fund additional employee benefits, or pay some or all of it into your pension in addition to your contributions. Please refer to the terms of your employer's scheme.

5. Is bonus waiver the same as salary sacrifice (SMART)?

Yes and no. Bonus waiver is a one-off decision to exchange some or all of your bonus for an additional pension contribution - much like regular contributions using SMART.

However, SMART is a contractual agreement relating to regular pension contributions. Bonus waiver, on the other hand, does not apply to your regular salary - only to individual bonuses. To be effective for income tax and NIC purposes, the decision to 'waive' bonus (in exchange for a pension contribution) must be declared prior to you being told what your bonus will be. Once this declaration has been agreed, it is, in theory at least, irrevocable and legally binding.

Speak with your HR or payroll team to check whether bonus waiver is relevant for you.

6. Is there a limit to the amount of salary I can give up?

Yes. Pensions are subject to limits on the amount of tax-relievable contributions you can make each year - and SMART contributions are included in these limits. For most people, the maximum they can pay into a pension each year is the lower of £40,000 or 100% of their annual earnings. See page 5 for more information.

In addition, it is not legal to use SMART to reduce your salary so that it falls below the National Living Wage (NLW) or National Minimum Wage (NMW).

Your employer may also cap the amount of salary you can exchange each year in your SMART scheme rules. Please check with your HR or payroll team for details of the specific terms applying to your scheme.

7. Does SMART have any other advantages?

Yes. Two categories of employees can use SMART to avoid tax traps:

People earning over £100,000 a year lose £1 of their personal income tax allowance for every £2 earned. Your personal allowance of £12,500 is lost entirely when your annual income reaches £125,000 — meaning you are effectively paying tax at a rate of 60% on £25,000. The Institute of Fiscal Studies (IFS) estimates that over a million people are now hit by this double taxation.

Parents earning between £50,000 and £60,000 a year gradually lose Child Benefit by way of an income tax charge. Only one charge is payable, by the higher earner in the household. For every £100 earned in excess of £50,000, 1% of Child Benefit will be clawed back.

These charges can be mitigated or eliminated. Making SMART pension contributions can enable you to reduce your salary to below, or nearer, the £50,000 or £100,000 thresholds — so your tax liability will be lessened.

8. Does SMART affect my other employee benefits?

No. Any other benefits that your employer may offer will be unaffected. For example, life cover (sometimes known as 'death in service'), income protection, employer pension contributions, percentage pay rises, overtime rates and so on will be based on your **reference salary** (your pre-SMART salary).

9. Does SMART affect state benefits?

SMART has no impact on your state pension. A single-tier flat-rate state pension was introduced in 2016. This is based on qualifying years, not earnings, so is unaffected by SMART.

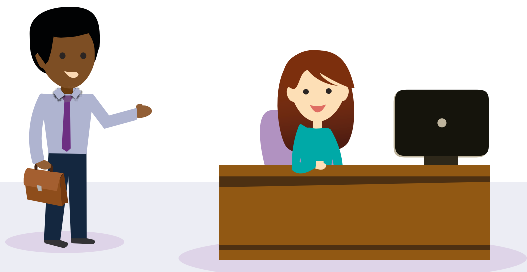
However, some other state benefits may potentially be affected by SMART — but this is a complex area. Generally, benefits that are linked to earnings or NICs are based on thresholds and duration of payments rather than actual amounts. We would suggest discussing this with your HR or payroll team if you are uncertain.

10. Does SMART affect statutory income declarations?

Possibly. If you are required to provide income declarations in respect of (for example) tax credits, child maintenance, student loan repayments or court orders, you will need to consider whether your position would be better or worse if you use SMART. If you are unsure, speak with your HR or payroll team in the first instance, and seek specialist advice if necessary.

11. Does SMART affect my ability to borrow money?

It shouldn't. Usually, your reference salary is used by lenders when you apply for mortgages and other loans. Some lenders use an income and outgoings ratio to establish how much you can borrow, and this would include pension contributions anyway, regardless of whether they are made via SMART.



SMART contract rules

Making SMART pension contributions requires agreement from HMRC that the reduction in your salary is 'genuine'.

This means that SMART contributions form part of your contract of employment, and you are normally required to commit to your SMART arrangement for at least 12 months.

SMART is beneficial for most people, but not all. If you are at all unsure of whether to make SMART contributions, please speak with your HR or payroll team.

SMART schemes vary across different employers — and your employer may use the terms salary sacrifice or salary exchange (or even salary conversion). Some employers cap the amount of salary you can exchange each year. Some employers operate a 'change window', meaning that you can only join or leave the scheme during a predetermined period each year - unless a 'lifestyle event' occurs. Lifestyle events again vary between employers, but would typically include things like marriage or divorce, serious illness or becoming a parent.

Find out more

For more information on any of the issues raised in this guide, or to speak with a financial wellbeing consultant about your own personal circumstances, please get in touch:

T: **0345 218 3126**
E: **fwb@loricasaltus.co.uk**
W: **lorica.com**

@LoricaFinWell

Important information

The contents of this guide are provided as information only and should not be relied upon as advice. The information is based on our understanding of current legislation in England and Wales. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend on your personal circumstances.

If you are at all unsure, you should not act on any of the information provided without first seeking professional advice.