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Salary sacrifice and the new Health and Social Care Levy – changes and challenges

Last month the government announced that National Insurance contributions will increase by 1.25% across the UK from April 2022, with the projected £12bn annual income to be ringfenced to pay for health and social care. Whilst this increases the taxes paid by individuals and employers, introducing or reviewing salary sacrifice arrangements for pension contributions might help employers mitigate some of these increased costs.

What are the increases?

From 1 April 2022, there will be a temporary 1.25% increase in class 1 (employee) and class 4 (self-employed) National Insurance contributions (NICs), as well as a 1.25% increase in class 1 secondary NICs paid by employers.

From April 2023, the increases will be treated separately as a Health and Social Care (H&SC) Levy and NICs rates will return to 2021/22 levels. The revenues from the levy will be ringfenced for health and social care. From that date, the H&SC Levy will also extend to individuals over State Pension age in employment or self-employment, who are currently exempt from paying NICs.

	Employee Class 1 NICs Main rate[1] / Higher rate[2]	Employer Class 1 NICs
For 2021/22	12% / 2%	13.8%
For 2022/23	13.25% / 3.25%	15.05%
From 2023/24	12% / 2% (plus 1.25% H&SC levy)	13.8% (plus 1.25% H&SC levy)

[1] For the 2021/22 tax year this applies to those who earn between £9,568 and £50,270 per annum
[2] For the 2021/22 tax year this applies to those who earn over £50,270 per annum

What's the impact on salary sacrifice arrangements for pensions?

Whilst this change will increase taxes for individuals and employers, it will also make pension contributions via salary sacrifice more efficient.

Currently £100 paid into a pension scheme via salary sacrifice normally only costs an individual £68 (if they are a basic rate tax-payer) or £58 (if they are a higher rate tax-payer), assuming they are under State Pension age and have the full standard personal allowance (£12,570 for 2021/22).

From 2022/23 these costs become £66.75 and £56.75, respectively. In addition, employers will save an increased amount in their NICs on the pay sacrificed for these pension contributions (albeit earnings paid to individuals will be subject to higher NICs, or the H&SC Levy from 2023/24).

These increased savings may prompt those employers who don't currently use salary sacrifice for pension contributions to introduce such an arrangement.

Where a salary sacrifice arrangement is already in place, employers may wish to review what happens to the NICs saving made by them. For some, the employer retains the saving. In this situation a higher saving on pay sacrificed for pension contributions will offset some of the increased costs on earnings paid.

Where employers pass some or all of their NICs saving to employees, they will need to consider whether to also pass on the additional savings, and check that payroll systems will be updated to apply the approach correctly, particularly when the H&SC Levy is introduced in 2023/24. As a result of the increased costs, some employers may also wish to revisit how their NICs savings are shared with employees to help offset the increased costs.

What about the timing of bonus payments?

Finally, employers may wish to consider, subject to commercial considerations, bringing forward bonus payments ahead of the changes in the NICs rates (if they are being paid to individuals) or delaying them until after the changes (if these payments will be sacrificed for pension contributions). If changing the timing of bonus payments, employers need to be mindful of the annual allowance as the changes may increase pension contributions above their normal rate.

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