

Salary Sacrifice – a tax saving opportunity for employees in 2008/09

March 2008

The sharp rise in the upper earnings limit for 2008/09 will create new salary sacrifice opportunities.

Rise of the upper earnings limit

The national insurance upper earnings limit (UEL) for employees for 2008/09 will be £770 a week (£40,040 a year), up from £670 a week (£34,840 a year) currently.

The personal income tax allowance for 2008/09 will be £5,435 and, while the basic rate band ceiling has not yet been confirmed, if it follows statutory indexation it will be £36,000 of taxable income, against a current £34,600. The gap between the UEL and the starting point for higher rate tax for someone entitled only to a personal allowance could thus shrink to £1,395 in 2008/09 (£5,435 + £36,000 - £40,040) against £4,985 this year (£5,225 + £34,600 - £34,840).

This produces some odd effects for employees with taxable benefits, such as a company car and private medical insurance. If the taxable value of their benefits in 2008/09 is more than £1,395 they will find themselves in a position where they are paying higher rate tax and full rate national insurance contributions (NICs) on part of their earnings. This opens up a bigger opportunity for salary sacrifice because the net income sacrificed will be that much lower. The example below shows what can happen.

Example

In 2008/09 Mike earns £40,000 a year and has a company car with a taxable value of £3,000pa. He is contracted into the state second pension (S2P). His net allowances are £2,435 (£5,435 - £3,000) giving him a tax code of 243L. His income is subject to tax and NICs as follows:

Band of earned income	Tax	NICs
£0 - £2,435	0%	0%
£2,435 - £5,435	20%	0%
£5,435 - £38,435	20%	11%
£38,435 - £40,000	40%	11%

Thus on the top £1,565 of his income Mike will be paying 40% income tax plus 11% NICs – a total of 51%. If he sacrifices that £1,565 of gross salary in favour of an employer pension contribution, he will effectively get 51% total relief, even if his employer pockets all its NIC saving. If the employer chips in its NIC saving, the effective rate of relief rises to 56.6%.



In 2009/10 the UEL is due a further inflation-beating rise, in line with the announcement in the March budget. The second hike will see the UEL equal to the 2009/10 personal allowance plus the 2009/10 basic rate band (which itself will be increased by £800 a year above indexation). The resultant UEL could be around £830 a week (£43,160 a year), which will create more scope for the type of salary sacrifice described above. In addition, in 2009/10 the introduction of the upper accrual point will mean there is a slice of earnings which could attract 11% NIC but no S2P accrual (or contracted out rebate), making salary sacrifice even more attractive

Salary sacrifice for employees on the margins of higher rate tax will become more attractive next year so employees should start talking to their employers now to determine the best way forward.

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