

Salary sacrifice

This factsheet explains the implications for USS benefits if an employer provides a 'salary sacrifice' arrangement in respect of ordinary USS contributions.

What is a salary sacrifice?

A salary sacrifice happens when an employee gives up the right to receive part of his/her pay, usually in return for the employer providing some form of non-cash benefit. The advantage to the employee is lower tax and national insurance contributions; the employer also saves on its national insurance contribution.

Since 1 April 2007, institutions have also been able to introduce salary sacrifice in respect of the ordinary USS contribution paid by members. Effectively the employer then pays the members' pension contributions for them, however their salary is reduced by the amount of those contributions.

How does this affect USS pension benefits?

Salary sacrifice arrangements have no effect on the salary used in any USS benefit calculations and the employer must continue to pay the full amount of pension contributions to USS based on the salary before any sacrifice is made. Here's a simple example to illustrate how this works for a salary sacrifice arrangement for ordinary USS pension contributions:-

Salary before 'sacrifice'	£40,000
Standard USS contribution	£3,000 (7.5%* of £40,000)
Salary after 'sacrifice'	£37,000 (earnings on which tax and NI are levied)
Employee contribution paid by the employer	£3,000 (in addition to the normal employer contribution)
Contribution paid by employee	NIL
Salary reported to USS by employer	£40,000

* 7.5% for illustration purposes only.

The member saves on national insurance (tax relief would have been granted in any case on the member's contribution, so there's no saving there) and does not pay any contribution to USS. This is a very simple example of how it works; the savings vary dependent on the member's salary.

Refund restriction

When a member, who has been in a salary sacrifice arrangement for ordinary USS contributions, leaves USS with less than two years' qualifying service, any refund payable would not include those contributions paid by the employer under the salary sacrifice arrangement. In practice that may result in a very small refund being available or none at all.

Members should take this restriction into account when deciding upon whether to participate in a salary sacrifice arrangement if they may leave USS after a short period and would like the option of a refund. However, if a refund is not required, the alternative is deferred benefits based on the contributions paid by the employer under the salary sacrifice arrangement (plus any contributions paid by the member before entering into the arrangement). The value of these deferred benefits could be transferred to another pension scheme. The amount transferable, which would not be less than the contributions used to calculate the deferred pension, would be calculated using the member's pensionable salary and pensionable service, which usually provides an amount in excess of the contributions.

Maternity leave

Statutory Maternity Pay (SMP) must not be reduced for employees taking part in a salary sacrifice arrangement prior to embarking on maternity leave. If an employee is entitled to contractual maternity pay, which exceeds SMP, then pension contributions may be deducted from maternity pay providing the remaining payment to the employee does not fall below the current level of SMP.

Employers must provide employees with full details of their salary sacrifice arrangements.