Take a pay cut – save a packet

We reveal how giving up part of your salary could save you money on your pension, childcare and travel

CUTTING THE COST OF CHILDCARE

Stephen and Hayley Fearnside

44 and 36, both surveyors

Stephen and Hayley have a three-year-old daughter, Hannah, who attends nursery three days a week at a cost of £382.50 a month.

Hayley and Stephen (who work for the same employer) both claim childcare vouchers for half of the cost of the nursery each.

Stephen told us: 'We've worked out that claiming childcare vouchers saves us about £110 a month in tax and National Insurance – effectively reducing the cost of the childcare to £272. We are really big fans of the scheme and would wholeheartedly recommend that anyone who has to pay for childcare considers taking vouchers.'

EMPLOYER BENEFITS

How can salary sacrifice benefit the boss?

If you are an employer, salary sacrifice can also save you money. Although there will be an administrative cost, employers save on the National Insurance (NI) they have to pay for employees who take part in salary sacrifice. For example, childcare voucher providers estimate employers save around £370 a year for every employee who orders the maximum number of vouchers. If this were multiplied across 50 employees, this would give the employer a saving in NI contributions of £18,500 a year.

Giving up part of your salary might sound like a mad idea, but it can make sense. Salary sacrifice, which some employers offer, lets you exchange part of your salary for a non-cash benefit.

This isn't a new concept but, until recently, was mainly used just with pensions. You can still use salary sacrifice to boost your pension (see 'Key salary sacrifices', opposite), but you can now also give up salary in return for benefits such as bikes, childcare vouchers, mobile phones and, in certain areas, bus passes. If you don't know whether your employer offers salary sacrifice, just ask. If your employer doesn't, you can try to lobby for salary sacrifice to be introduced (See 'Contacts', below, for more help on this).

Many employers offer 'fringe benefits'. Some of these, such as cars, are taxable; others are not. It's the tax-free fringe benefits (as opposed to the taxable ones) which are often the subject of salary sacrifice schemes, because they offer National Insurance (NI) savings to employers as well as tax and NI savings to employees.

Contacts

Chartered Institute of Personnel and Development 020 8612 6202 www.cipd.co.uk

Daycare Trust 020 7840 3350 www.daycaretrust.org.uk

HMRC www.hmrc.gov.uk

Some scheme providers:

Cyclescheme 01225 448933 www.cyclescheme.co.uk

Halfords Cycle Scheme 0870 066 0511 www.halfordsb2b.com/bikes4workscheme.asp

Kiddivouchers 0845 094 1412 www.kiddivouchers.com

GreenTravel2Work 01908 352 067 www.pmmemployeebenefits.co.uk

How it works

Salary sacrifice is a legal arrangement which reduces the salary you are entitled to receive under your terms of employment and allows you to receive a non-cash benefit in return. As you receive less salary, you pay less tax and National Insurance, so this reduces the true cost of the benefit.

However, as your salary is reduced, this can affect state benefits, and you should check with your employer to make sure your bonuses, pay increases and pension benefits won't also be affected.

In 'Key salary sacrifices', opposite, we look more closely at how three popular types of salary sacrifice – bike rental, childcare vouchers and pension uplifts – may work, and show examples of savings you could make.

Flexible benefits

Some employers offer flexible benefit packages which allow employees the ability to buy extra or different benefits from the ones the employer offers as standard. For example, you might choose to buy additional life insurance, critical-illness cover, or to extend benefits like private health insurance or health screening to your partner.

You can also choose to 'buy' additional holiday, or, if you prefer, give up holiday in return for extra cash. These schemes are sometimes known as 'cafeteria benefits' or 'flex plans', and essentially they allow employees to vary their pay and benefits package in order to suit their own personal requirements.

You may be able to get benefits such as extra life insurance or critical-illness cover cheaper by buying through your employer, as your employer is able to 'bulk buy'.

KEY SALARY SACRIFICES

We look at how giving up salary in return for a bike, childcare vouchers and additional pension might work

On your bike

You choose the bike you want, which is bought by your employer. The employer then leases the bike to you. Many employers can reclaim the VAT and therefore have the option of passing this saving on to the employee. The employee's salary is reduced by the net cost of the bike for the payment period (usually one year), and this pays for the lease of the bike during the hire period (which may be longer than the payment period, for example, three years).

As your salary is reduced, tax and NI are also reduced. After the hire period ends, the employer may agree to sell the bike to the employee at a 'fair market value'.

So the scheme doesn't fall foul of the tax rules, the fair market value

must represent what a second-hand bike of that make and condition would be worth if sold on the open market, and the employer must be able to show the tax office how it reached this figure.

Here's how it might work for someone earning £30,000 a year during tax year 2007-08. Payment period is set at 12 months, but total hire period is set at 36 months (but the employee pays only for one year).

MONEY SAVED £379

- Monthly take-home pay after tax and NI: **£1,840.77**
- Full cost of bike: £850 plus VAT of £148.75: **£998.75**
- Employer purchases bike and reclaims VAT
- VAT saving passed to employee, so salary sacrificed is: **£850**
- Salary reduced to **£29,150** for 12 months
- Monthly take-home pay after tax and NI on £29,150: **£1,793.31**
- Difference in monthly take-home pay for 12 months: **£47.46**
- After 36 months employee buys the bike at fair market value plus VAT
- On an **£850** bike this might typically be **5 per cent** of purchase price plus VAT: **£49.94**

Total cost of bike

- Difference in take-home pay for 12 months: **£569.52**
- Fair market value price of bike + VAT: **£49.94**
- Actual cost of bike to employee: **£619.46**
- Saving on the full cost of the bike (£998.75): **£379.29**

Pension boost

You already get tax relief on your pension contributions, but you can increase what you pay into your pension and both you and your

employer can save on NI by giving up part of your salary and directing it to your pension instead.

The example on the right shows how a salary sacrifice scheme can boost the pension of someone paying into an employer's group personal pension scheme (GPP).

In the example shown, the employer would also save on NI contributions (£128) and might be persuaded to add this saving to the contribution, boosting the amount paid towards pension even more.

Here's how it might work for someone earning £25,000 during 2007-08 where both employee and employer pay 3 per cent of salary into a GPP.

MONEY GAINED £262

Before salary sacrifice

- Employee contribution: 3 per cent of £25,000 (£750 plus tax relief): **£962**
- Employer contribution: 3 per cent of £25,000: **£750**
- Total contribution: **£1,712**

After salary sacrifice

- Employee contribution: 3 per cent of £24,000 (£720 plus tax relief): **£923**
- Employer contribution: 3 per cent of £24,000 plus £1,000 from salary sacrifice: **£1,720**
- Total contribution: **£2,643**
- Increase to pension contribution because of salary sacrifice: **£931**
- Less difference in take home pay: **£669**
- Net boost to pension: **£262**

Bringing up baby

Since April 2005, employees can receive up to £55 a week or £243 a month in childcare vouchers, free of tax and National Insurance.

You receive the same salary as usual, but part of it is paid to you as tax-free childcare vouchers, which you pass on to your childcare provider. Both parents can claim, effectively doubling the benefit, and higher-rate taxpayers save even more. However, if you are claiming tax credits to help with the cost of your childcare, you might lose out if you claim childcare vouchers. Check with the tax credits helpline on 0845 300 3900.

Which? member Rebecca Robertson said: 'Both myself and my husband give up salary in exchange for the maximum childcare vouchers – it's excellent, as we save tax and NI.' (See 'Cutting the cost of childcare', opposite, for more happy parents.)

Here's how it could work for someone earning £30,000 a year in 2007-08 and claiming the maximum childcare vouchers of £243 a month.

- Tax and NI paid on salary of £30,000 during tax year: **£7,910.90**
- Tax and NI paid on salary of £30,000 where max of **£243** a month (**£2,916** a year) is paid in childcare vouchers: **£6,948.62**
- Saving over the tax year: **£962.28**

MONEY SAVED £962