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Assessing the announced reform to salary sacrifice pension contributions

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Economic
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- Salary sacrifice pension contributions made by employer in return for employee giving up part of their salary
- Currently exempt from National Insurance Contributions (NICs)
- From 2029–30, salary sacrifice pension contributions above £2,000 per year no longer exempt from employee and employer NICs

- One of the largest revenue-raising measures in the Budget
 - Expected to raise £4.7bn in 2029–30; £2.6bn in 2030–31

- We provide evidence on which groups most likely to be affected
- Provide an overall assessment of the reform

- Use Annual Survey of Hours and Earnings (ASHE) 2021
 - Contains information on earnings and salary sacrifice contributions

- Uprate earnings and contributions to 2029–30 by average earnings growth

- ASHE does not capture bonus-sacrifice arrangements well
- → Assume 47.25% of received bonus earnings are sacrificed into pensions for employees with salary sacrifice DC pension

Potential behavioural responses to the reform

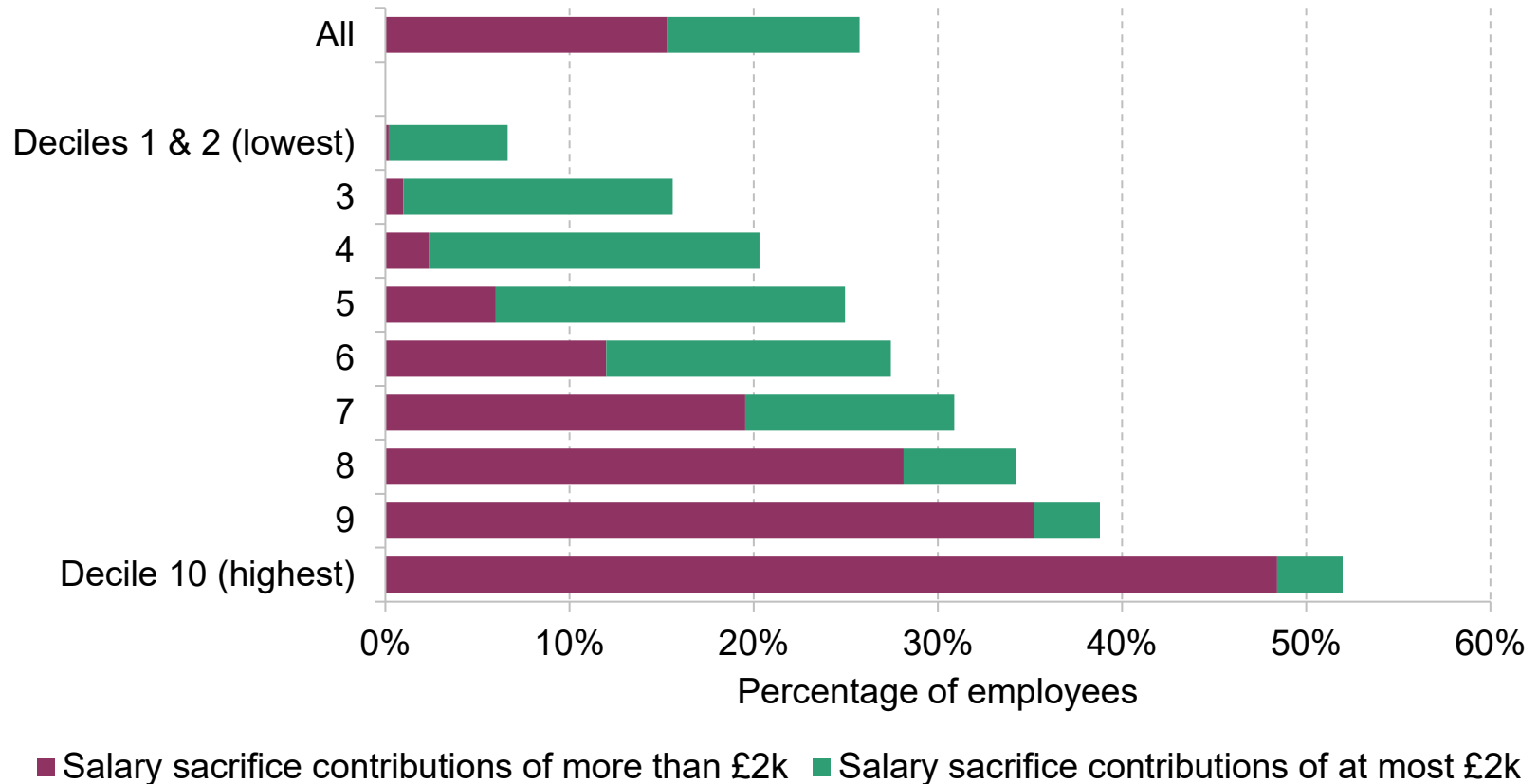
- Potential behavioural responses – which we are generally not modelling – include:
 - Employers could change their pension offering
 - Employees might reduce salary sacrifice pension contributions
 - Employees could reduce hours worked
 - Employers could reduce remuneration and hiring
- The magnitude of these responses – and who will make them – is highly uncertain
- Our analysis mainly abstracts from these behavioural responses



Which groups are most affected by the reform?

Higher earners much more likely to salary sacrifice >£2k per year

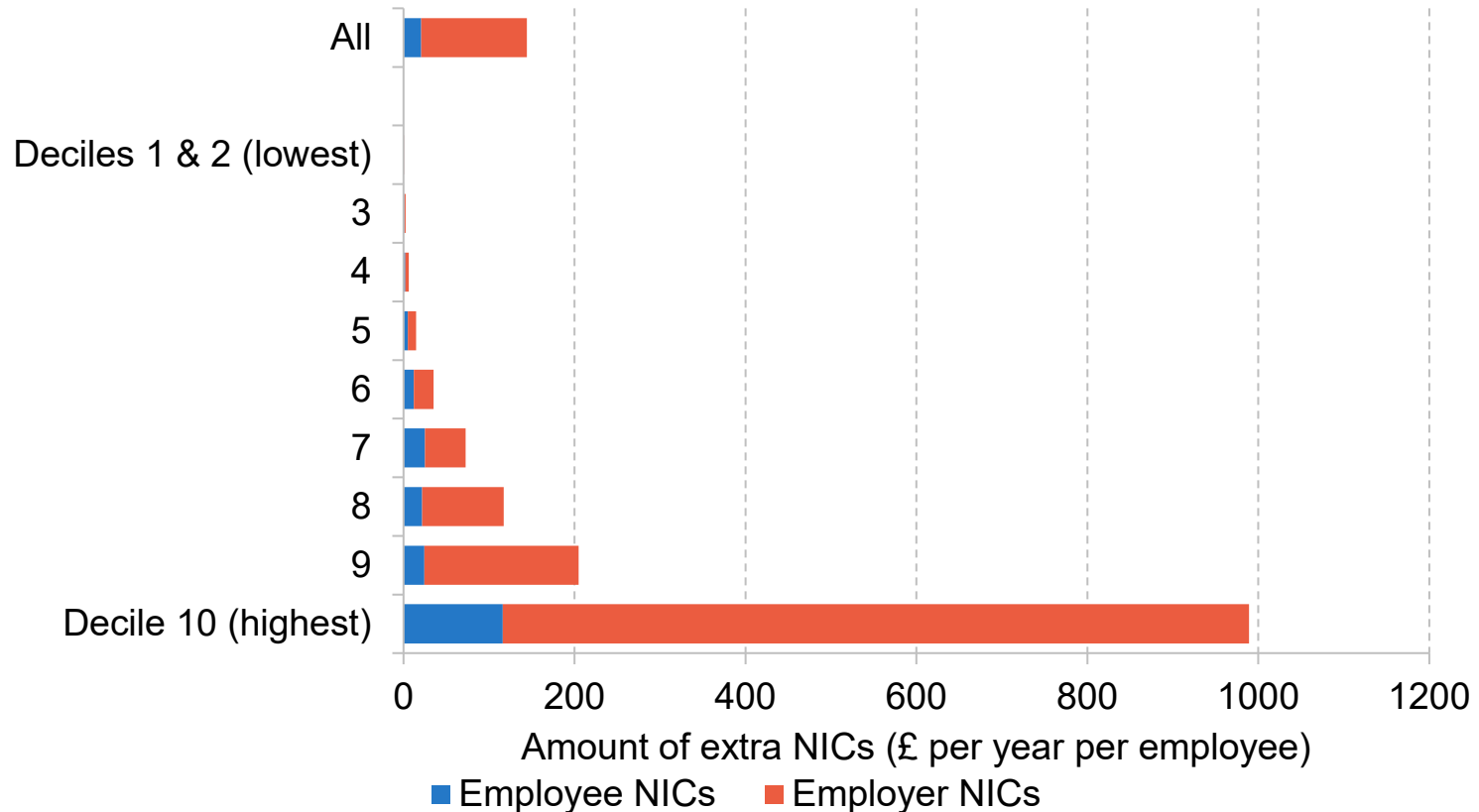
% of employees salary sacrificing into a pension, by earnings decile



Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary-sacrifice DC pension.

Additional NICs mostly in top two deciles

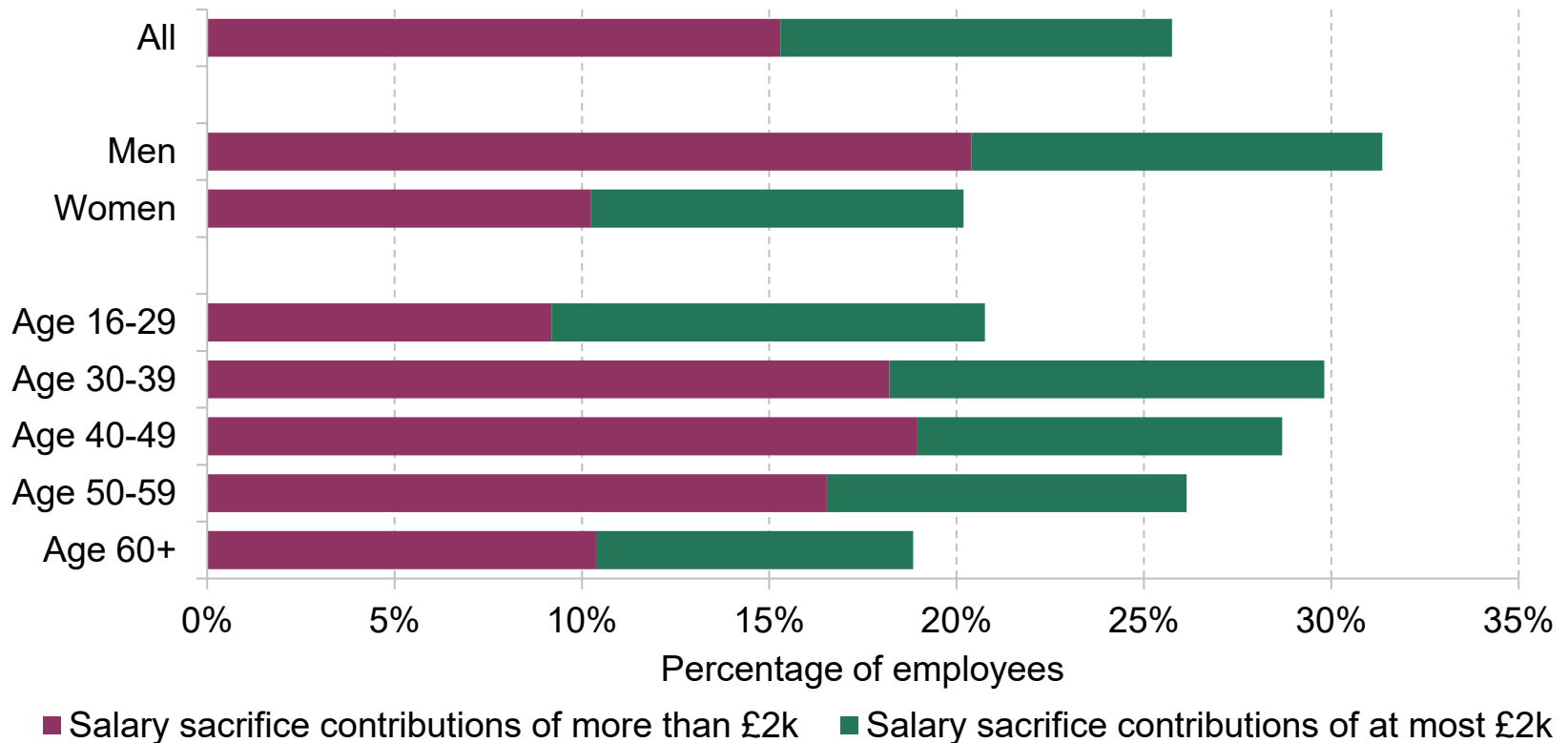
Mean extra yearly NICs per employee assuming no behavioural change, by earnings decile



Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary sacrificed DC pension. £2,000 threshold is in 2029-30 prices, all other £ values are in current prices.

Men and middle-aged employees more likely to salary sacrifice

% of employees salary sacrificing into a pension, by sex and age group

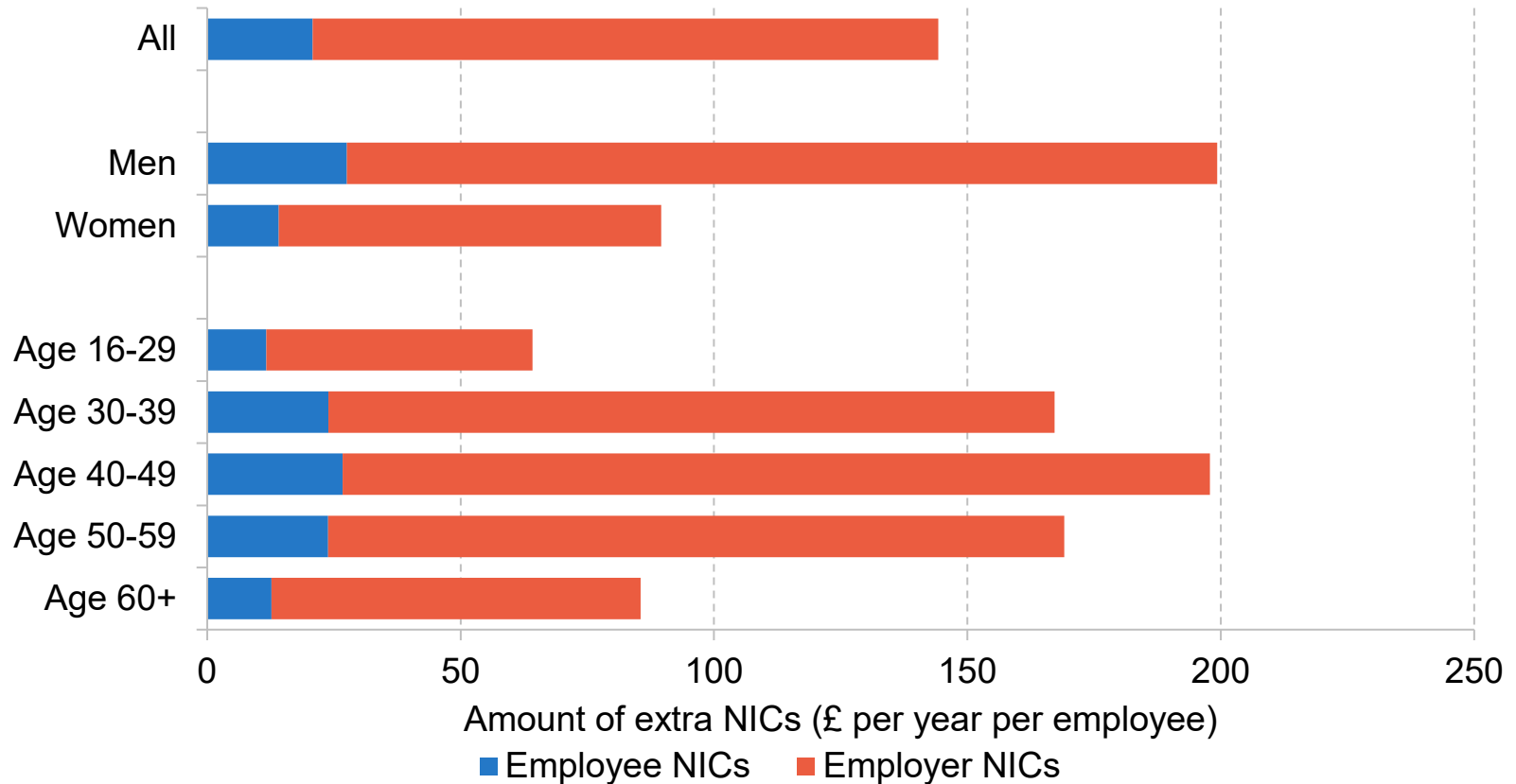


Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary-sacrifice DC pension.

Source: IFS calculations using the Annual Survey of Hours and Earnings, 2021.

Extra NICs liabilities largest for men and middle-aged employees

Mean extra yearly NICs per employee assuming no behavioural change, by sex and age, across all employees (including those not directly affected)

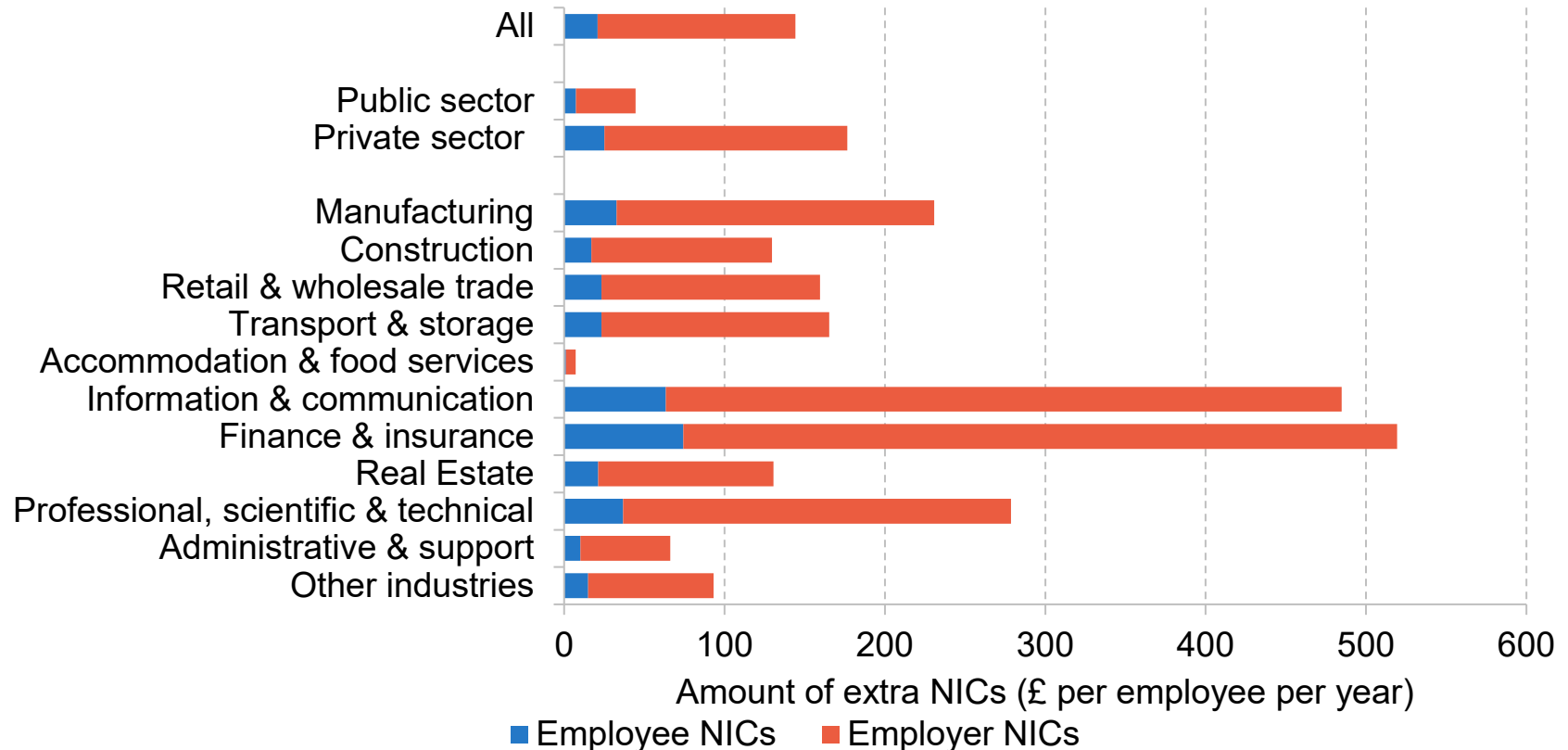


Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary sacrificed DC pension. £2,000 threshold is in 2029–30 prices, all other £ values are in current prices.

Source: IFS calculations using the Annual Survey of Hours and Earnings, 2021.

Average extra NICs per employee varies substantially by industry

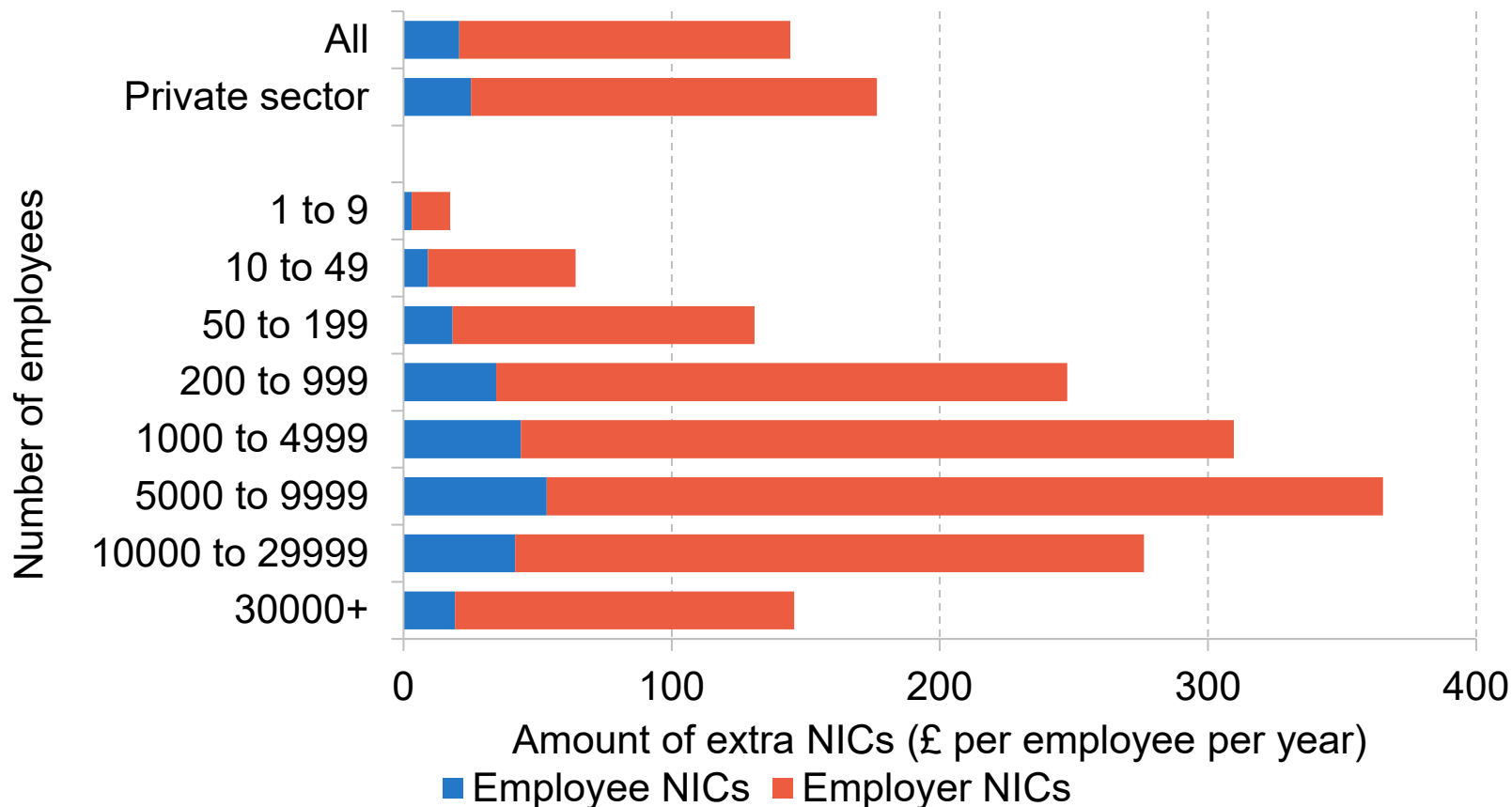
Mean extra yearly NICs per employee assuming no behavioural change, by sector and industry (across all employees, including those not directly affected)



Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary sacrificed DC pension. The industry split includes private sector employees only. £2,000 threshold is in 2029–30 prices, all other £ values are in current prices.

Distribution of average extra NICs per IFS employee by employer size

Mean extra yearly NICs per employee assuming no behavioural change, by employer size (private sector only; across all employees, including those not directly affected)



Note: We uprate earnings and pension contributions to 2029-30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary sacrificed DC pension. £2,000 threshold is in 2029–30 prices, all other £ values are in current prices.

Source: IFS calculations using the Annual Survey of Hours and Earnings, 2021.

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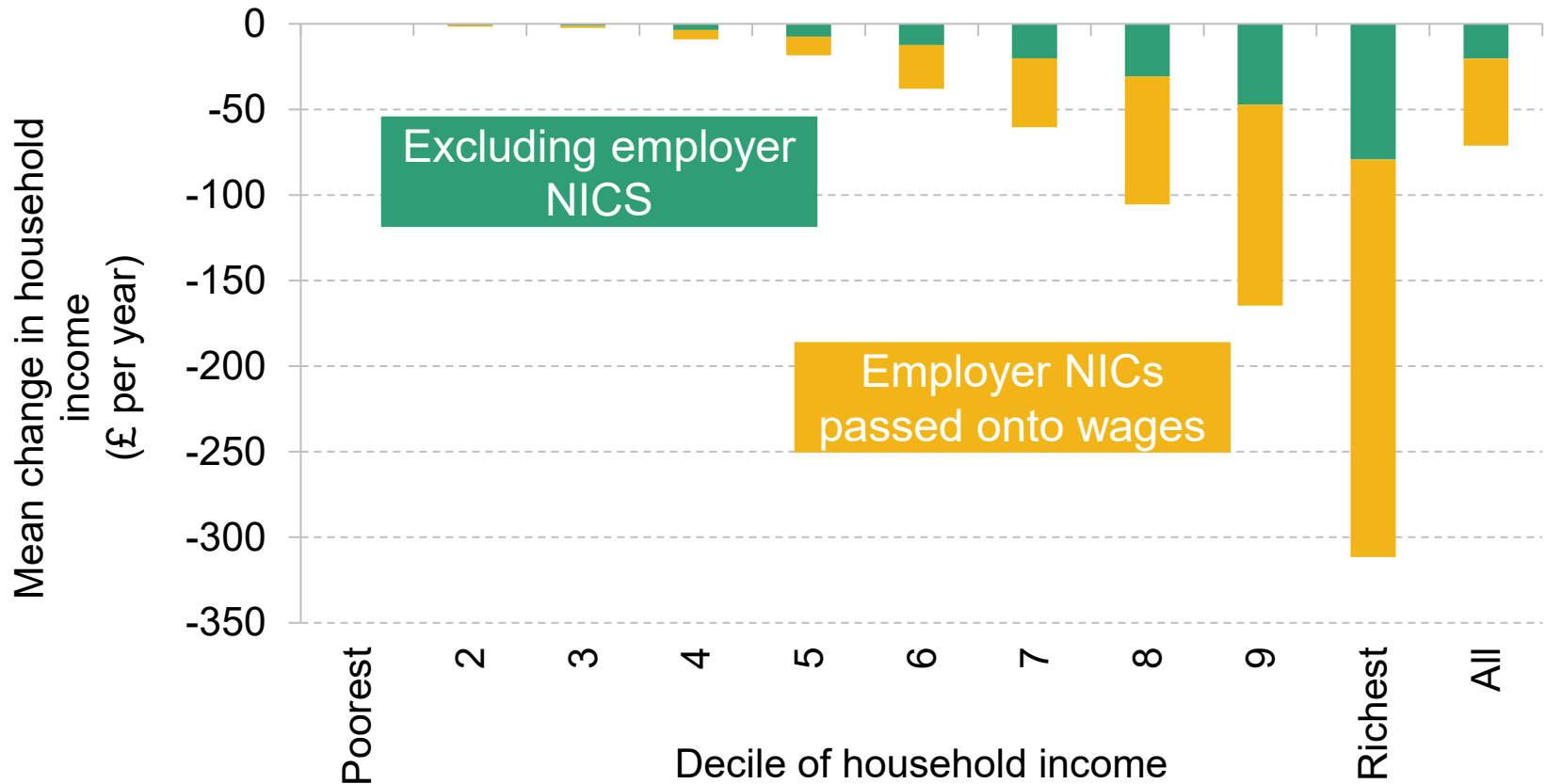
Distributional analysis of reform



- Use IFS tax and benefit micro-simulation model using Family Resources Survey with ASHE
- Show how reform affects household income across distribution
- And to account for other interactions with tax and benefit system
- To account for distributional effects of employer NICs, have to make assumption about incidence i.e. “who pays them”
- Show distributional effects both:
 - excluding employer NICs
 - assuming employers reduce pay one-to-one

Highly progressive overall distributional impact

Household income impact of salary sacrifice changes by decile of household income



Note: Salary sacrifice contributions are imputed using 2021 ASHE updated to 2029–30 by average earnings growth. All £ amounts in 2025-26 prices.

Source: IFS tax and benefit microsimulation model, TAXBEN. Family Resources Survey 2022–23 updated to 2029–30. Annual Survey of Hours and Earnings (2021).



Assessing the reform

Fundamental issue with NICs treatment of pension contributions

- Employer pension contributions never subject to NICs
- Not clear this is the best way to incentivise these contributions:
 - Financial incentive linked to headline NICs rates
 - Incentive is opaque
- Creates asymmetry in tax treatment of employer and individual pension contributions
 - Subsidy offers no incentive to save for self-employed
- Salary sacrifice → “individual” contributions can receive NICs relief
 - But remains an arbitrary distinction between salary sacrifice and ordinary individual pension contributions
 - NICs relief on salary sacrifice contributions also opaque

Assessing this reform

- The announced reform reduces an arbitrary distinction in the tax system while exacerbating another
 - Does not address the fundamental issue with NICs treatment of employer pension contributions
- The reform will also add to the complexity of the tax system
 - Employers and HMRC need to keep track of these contributions
- → Not clear this reform improves overall design of how pensions are taxed

An alternative reform

- Scrap the NICs relief of employer pension contributions
- And replace it with a new, less generous, subsidy for employer pension contributions

- This package would:
 - Reduce asymmetry in tax treatment of individual/employer conts
 - Incentivise saving among groups exempt from employer NICs
 - Ensure incentive does not change inadvertently with changes in employer NICs rates

Summary

- Higher earners particularly likely to be affected by reform
- Private sector much more affected than public sector
 - Particularly finance & insurance and information & communication
- Wide variety of potential behavioural responses

- Policy does not address fundamental issue with NICs treatment of pension contributions
- More ambitious reform could have raised similar revenue while improving coherence and targeting of pension tax system

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