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Laurence O'Brien
Matthew Oulton

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Executive summary

In November 2025, the Chancellor announced that salary sacrifice pension contributions – whereby employees agree to a reduction in their salary in return for additional employer pension contributions – above £2,000 per year will no longer be exempt from employer and employee National Insurance contributions (NICs) from 2029–30 onwards. In this report, we provide evidence on which groups of employees are currently more likely to make salary sacrifice contributions above this threshold and the types of employers they work for. We also show how much extra NICs these groups would be liable for due to the policy if they continued to make the same contributions.

The ultimate impact of the policy will depend on how different groups of employees and employers respond. There is a range of different potential behavioural responses to the policy, including changes in pension contributions, remuneration and hours worked. The magnitude of these responses – and who will make them – is highly uncertain, leading to considerable uncertainty about the revenue raised by the reform. As a result, although we discuss these behavioural responses, our empirical results abstract from them for the most part, showing who would be most affected by the policy based on current contributions.

Key findings

1. **Higher-earning employees are much more likely than lower earners to make salary sacrifice pension contributions of more than £2,000 per year.** Overall, 15% of employees make salary sacrifice contributions above this threshold. Among the lowest-earning fifth of employees, this share is less than 1%, compared with 48% for employees in the top 10% of the distribution. This is both because higher earners are more likely to use a salary sacrifice pension scheme and because they are more likely to contribute more than £2,000 per year to a pension. 69% of the total additional NICs liability is borne by the top earnings decile and their employers.

2. In addition to particularly impacting high-earning individuals, **the policy mainly affects the top tenth of the household income distribution**. If pension contributions remained unchanged and employers were to pass on the extra employer NICs through reductions to affected employees' wages, households in this top decile would lose, on average, over £300 per year due to the policy. Around 65% of households in the top

decile would experience no change in income as they do not use salary sacrifice. The average loss among affected households in the top decile of the household income distribution would be £888 per year. Households in the bottom decile of the income distribution would – under the same assumptions – see virtually no change in household income. Of course, in practice, the reforms may well impact some households who currently do not make salary sacrifice contributions above £2,000 – for example, if affected employers reduce wages of these employees or if these employers stop offering salary sacrifice arrangements altogether.

3. **The private sector will be affected by the policy to a much greater extent than the public sector because it makes greater use of salary sacrifice.** 18% of private sector employees make salary sacrifice pension contributions of more than £2,000 per year, compared with only 7% of public sector employees. The resulting average yearly increase in employer NICs in the private sector (£151 per employee) is over four times that in the public sector (£37). Public sector employees are more likely to receive large employer pension contributions, which are unaffected by the policy.

4. **Within the private sector, there is substantial variation in the impact of the policy across industries.** Almost 40% of employees in finance & insurance and information & communication are making salary sacrifice contributions of more than £2,000 per year. This compares with less than 2% of employees working in accommodation & food services.

5. Whether the announced change would improve the system of pension taxation in the UK is up for debate. It would certainly add complexity to the system. **In addition, it would do little to address fundamental issues with the NICs treatment of pension contributions.** The fact that employer pension contributions are not liable for NICs either at the point of contribution or in retirement is the biggest tax break for pensions in revenue terms. However, this tax break is opaque, unavailable for the self-employed, and creates a fundamental asymmetry with the NICs treatment of individual pension contributions. The reform does not address this asymmetry – it reduces one arbitrary distinction in the tax system (between salary sacrifice and employee pension contributions), while creating another (between employer and salary sacrifice pension contributions).

1. Introduction

In November 2025, the Chancellor announced that salary sacrifice pension contributions – whereby employees agree to a reduction in their salary in return for additional employer pension contributions – above £2,000 per year will no longer be exempt from employer and employee National Insurance contributions (NICs) from 2029–30 onwards.[1]

This change was one of the largest revenue-raising measures in the Budget, with the OBR expecting it to raise £4.7 billion in 2029–30, falling to £2.6 billion in 2030–31 in nominal terms (Office for Budget Responsibility, 2026).[2] However, little is known about who will be affected by this tax.

In this report, we aim to bridge this gap, offering more insight into which groups of employees and employers are more likely to be directly affected by this reform. In particular, we analyse which types of employees are more likely to make salary sacrifice pension contributions, and the types of firms they work for. We outline how much extra NICs different groups would expect to pay if their pension contributions were unchanged, and we conclude by providing a brief evaluation of the policy.

Current National Insurance treatment of pension contributions

The NICs treatment of pension contributions depends on whether they are formally made by an individual or their employer. Pension contributions made by individuals are liable for both employee and employer NICs at the time the person is paid. In contrast, pension contributions formally made by employers attract neither employee nor employer NICs.

In retirement, pension income is not subject to either employee or employer NICs. Therefore, remuneration in the form of employer pension contributions is never subject to any form of NICs

1 The government has confirmed that the £2,000 threshold will not be uprated before 2029–30 (and has not confirmed how the threshold will be uprated thereafter). Throughout, we refer to the £2,000 threshold in nominal terms for clarity, although we express other monetary values in 2026–27 (current) prices, deflating using the Consumer Prices Index, except where otherwise specified. For reference, £2,000 in 2029–30 is worth £1,885 in current prices.

2 The bulk of this difference is driven by the OBR assuming that some employees will switch from net pay to relief at source arrangements in 2029–30. This temporarily boosts revenue as higher-rate taxpayers receive only basic-rate tax relief in 2029–30, before they then reclaim the rest of the relief from HMRC the following tax year.

– neither when it is paid into the pension, nor when it is taken out.[3] This generous NICs treatment of employer pension contributions is the biggest tax break for pensions in overall revenue terms (Adam et al., 2023).

As the NICs treatment of employer pension contributions is more generous than that of employee pension contributions, it is in the interests of both employees and their employers to make employer pension contributions in place of employee pension contributions where they can.

Salary sacrifice schemes provide exactly this opportunity. Under this arrangement, the employer makes higher employer pension contributions in exchange for a reduction in the employee's pay. Relative to a scenario in which the salary sacrifice contributions were instead made as an employee pension contribution, this reduces the tax liability for both the employer and the employee, since employer and employee NICs are avoided.

Importantly, this tax relief is not available to all workers. Not all employers offer salary sacrifice arrangements, and self-employed workers have no employer to make employer pension contributions on their behalf.

What is the announced policy?

In the November 2025 Budget, the Chancellor announced a substantial reform to the tax relief offered to employees making salary sacrifice contributions. From April 2029, salary sacrifice pension contributions above £2,000 per year will be subject to both employee and employer NICs. In other words, above this threshold, salary sacrifice pension contributions will be taxed identically to individual pension contributions. Ordinary employer pension contributions will remain exempt from NICs.

How might individuals and firms respond to the policy?

The bulk of our analysis in this report is based on the mechanical impact of the changes without factoring in behavioural responses. This means we document which groups of employees and employers are affected, and what the resulting NICs liabilities would be, without modelling

[3] Note that the NICs treatment of pensions differs from how pensions are treated for income tax. Contributions made to a pension are exempt from income tax. When pensions are accessed, 25% can be taken free of tax, with the remainder subject to income tax. The announced reform does not change how pensions are treated for income tax.

changes that employees and employers may make in response. Nevertheless, we expect several behavioural responses both by employees and by employers.

The first potential response is that employers could change their pension offering. As the policy change will mean that salary sacrifice pension contributions are no longer as tax-advantaged as employer pension contributions, employers might respond by increasing the standard contractual level of employer contributions and reducing pay. Due to Optional Remuneration Arrangements rules, it would be difficult for employers to target this only at people who currently make salary sacrifice contributions above the £2,000 threshold (Office for Budget Responsibility, 2026).

Rebalancing remuneration by increasing the offer of employer contributions and reducing (or limiting rises in) pay would help limit the impact on employers and directly affected employees. But because it could not be targeted only at these directly affected employees, it would negatively impact some employees who work at employers that offer a salary sacrifice pension scheme, but who currently choose not to make salary sacrifice contributions themselves. This is because it restructures their remuneration towards pension contributions in a way they would otherwise not have chosen. The official costing predicts that this response will reduce the tax revenue raised by £0.7 billion in 2030–31 in nominal terms (Office for Budget Responsibility, 2026).

Alternatively, some employers may stop offering salary sacrifice pension schemes at all due to the policy, as it will likely increase the administrative costs of these schemes while also making them less financially attractive. An employee working for such an employer and currently making salary sacrifice pension contributions of £2,000 or less would therefore also lose out from the policy, as they would only be able to make ordinary employee contributions instead.

Employees may respond by reducing their salary sacrifice pension contributions from 2029–30. The policy change makes saving into a salary sacrifice pension less tax-advantaged, which will discourage both employees and employers from doing it. Some employees might try to avoid paying any extra NICs by, for example, taking advantage of other salary sacrifice schemes, such as the cycle-to-work scheme. Some employees may switch to making ordinary employee contributions (on at least a portion of their contributions), as the tax asymmetry between salary sacrifice and ordinary employee contributions falls. More generally, as this change reduces the overall tax incentive to make pension contributions, we would expect total pension contributions to fall from 2029–30. On the other hand, before the changes are implemented in 2029–30, we may expect an *increase* in salary sacrifice pension contributions as employees shift forward their contributions in time in order to reduce their overall tax liabilities.

Alternatively, employees may respond to the change by reducing their hours of work. On average, the policy increases the effective tax rate on earning an additional pound for workers

who make salary sacrifice pension contributions. Consequently, workers will face a weaker incentive to work.

Finally, the policy increases the employer costs of employing people who currently salary sacrifice more than £2,000 per year. Employers might pass this on to employees by reducing remuneration or the number of workers they hire. This effect might not just be confined to those employees directly affected by the policy; for example, an employee who works at a firm facing a large increase in employer cost due to the change, but who does not make salary sacrifice themselves, could still face a reduction in remuneration. Any reduction in remuneration and hours worked due to the policy would reduce income tax and National Insurance receipts, reducing the revenue raised by the reform. While we would generally expect the long-run impact of higher employer NICs to be principally felt by employees,[4] in the shorter run employers could also respond by raising prices or accepting reduced profits, which in turn would impact consumers or shareholders respectively.

We do not incorporate these responses into most of our quantitative analysis for two reasons. First, avoiding extra NICs through a behavioural response does not mean an employee is unaffected by the policy. For example, if an employee switches from making salary sacrifice pension contributions to some other scheme to avoid paying more NICs (e.g. the cycle-to-work scheme), they are only able to keep their tax bill unchanged by changing their behaviour – something they would not have chosen to do absent the policy. The fact that they previously preferred salary sacrifice pension contributions means the switch itself makes them worse off, even if it leaves their overall remuneration and tax bill unchanged. As a result, the impact of the policy before behavioural responses may be a better guide to the distributional impact on welfare than the impact after behavioural responses.

Second, it is hard to model behavioural responses accurately. The official costing of the policy by HMRC (and certified by the OBR) relies on a range of assumptions about the scale of different responses (Office for Budget Responsibility, 2026). Modelling such responses differently for different groups would require yet more assumptions beyond those made by the OBR and would add additional uncertainty to our results.

[4] See https://ifs.org.uk/taxlab/taxlab-taxes-explained/national-insurance-contributions-explained for a discussion of 'who pays' National Insurance. The OBR also assumes that the majority of employer NICs are passed on as lower remuneration (Office for Budget Responsibility, 2026).

2. Which groups are most affected by the reform?

To assess which groups of employees and employers would be most directly affected by the reform, we use the Annual Survey of Hours and Earnings (ASHE), a representative survey containing employer-reported information on earnings and pension contributions for a large random sample of employees in UK. Importantly, this data set distinguishes between employee, employer and salary sacrifice pension contributions (unlike administrative data collected by HMRC, which cannot split out salary sacrifice pension contributions from ordinary employer contributions). ASHE also contains some limited information on employee and employer characteristics.

For each employee in this data set, we can observe their reported amount of salary sacrifice pension contributions.[5] We make two adjustment to these amounts. First, the reform is not due to come into effect until 2029–30, but the latest ASHE data containing pension information that we have access to are from 2021. We therefore uprate pay and pension contributions to 2029–30 in line with observed and OBR forecast average earnings growth, before expressing all cash amounts in 2026–27 prices.[6] In addition, analysis from HMRC and the OBR suggests that ASHE does not accurately measure contributions to pensions sacrificed out of bonus payments. As a result, we follow HMRC and the OBR in assuming that 47.25% of received bonus earnings are sacrificed into pensions for employees with a salary sacrifice defined contribution pension (Office for Budget Responsibility, 2026).[7]

We use these data to compute the share of employees who make salary sacrifice pension contributions of over £2,000 per year and the implied employee and employer NICs liability. To reiterate an important earlier point, we assume no behavioural response for all analysis using

[5] In practice, ASHE collects data on pay and pension contributions for a pay period in early April each year. We annualise these values, given that the policy is based on annual salary sacrifice pension contributions. As a result, we assume that employees are employed throughout the year at stable earnings (aside from bonuses), have only one job, and are not self-employed on the side.

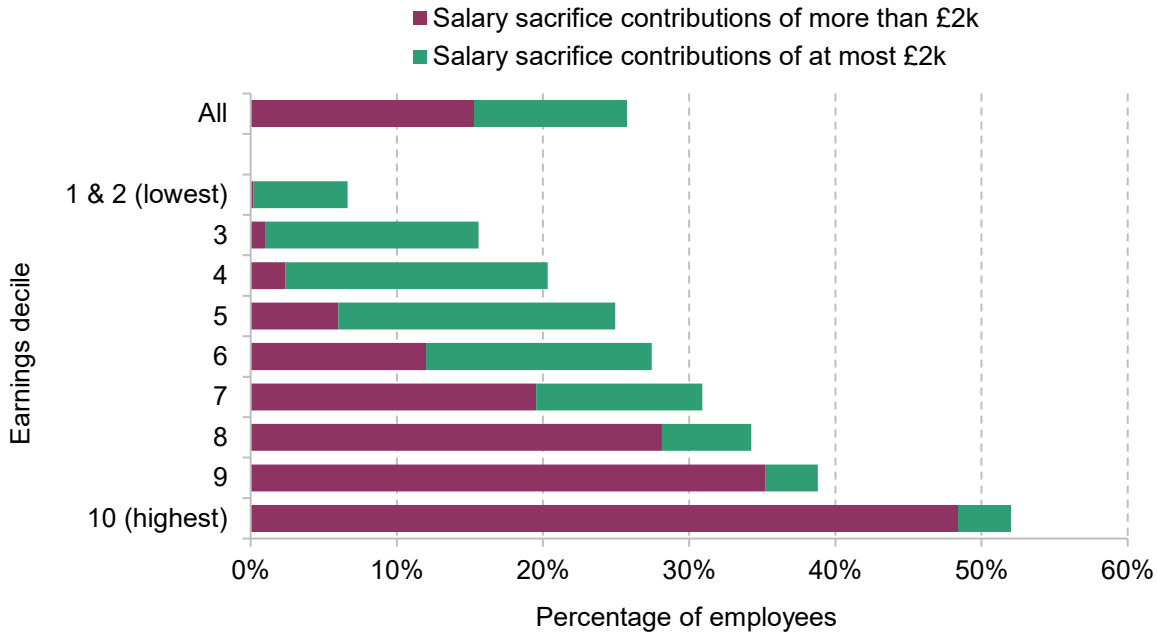
[6] Implicitly, we are assuming that the composition of the workforce – for example, the split between public and private sector workers – in 2029–30 will be the same as in 2021. Throughout, we deflate monetary variables using the Consumer Prices Index.

[7] In reality, the share of bonuses sacrificed into pensions likely differs between employees. For simplicity, we follow HMRC and the OBR and assume that this share is constant across employees. We use the *ipayall* variable for bonuses, rather than *ipayin*, as *ipayall* better matches levels of bonus pay overall, and by industry, from Average Weekly Earnings data. These results are available on request.

ASHE; that is, we compute these results without allowing salary sacrifice pension contributions to change due to the policy.

Overall, just over a quarter of all employees make salary sacrifice pension contributions, with around 15% of all employees contributing more than the £2,000 threshold, as shown in Figure 1. Note that this figure (and the figures that follow) is calculated across all employees (rather than just restricting to pension savers); that is, we include employees who are not making pension contributions at all. Among pension savers, around one-third make salary sacrifice pension contributions.

Figure 1. Share of employees salary sacrificing into a pension, split by whether salary sacrifice contributions are more than £2,000 per year, by earnings decile



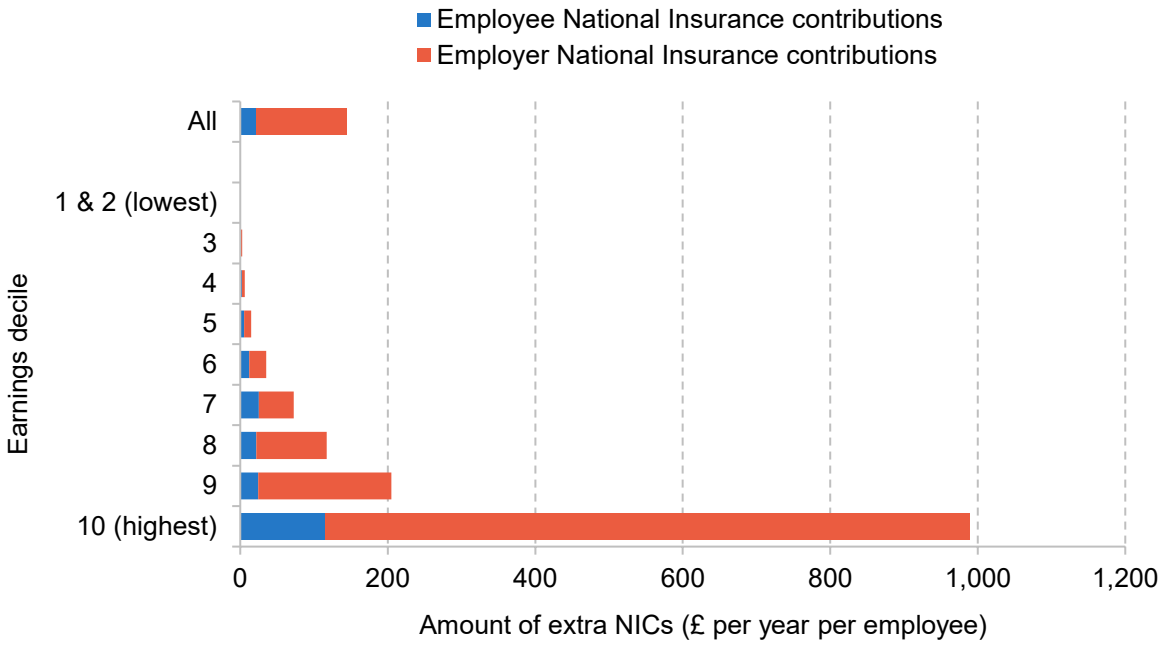
Note: We uprate earnings and pension contributions to 2029–30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. Deciles 1 and 2 are grouped due to disclosure requirements.

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 1 also shows that, unsurprisingly, there is a steep earnings gradient to *who* is directly affected by the policy. Higher earners are much more likely to make salary sacrifice contributions: over half of those in the highest earnings decile save in a salary sacrifice scheme, compared with just 7% of those in the bottom two earnings deciles. In addition, conditional on saving in a salary sacrifice scheme, higher earners are much more likely to make contributions exceeding the £2,000 threshold than lower earners. Consequently, 48% of employees in the highest earnings decile would be directly affected by the policy, compared with less than 1% of employees in the bottom fifth of the earnings distribution.

Without any behavioural response, the reform would lead to extra NICs of slightly over £140 per employee per year on average, the vast majority of which (£123) comes from employer NICs, as shown in Figure 2. This reflects the fact that most affected employees earn above the upper earnings limit (£50,270 per year) where the employer NICs rate of 15% far exceeds the employee rate of 2%.

Figure 2. Mean extra yearly National Insurance contributions 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 is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. £2,000 threshold is in 2029–30 prices; all other £ values are in current prices. The averages are calculated over all employees, i.e. including those who are not affected by the reform (e.g. because they are not saving into a pension at all). Deciles 1 and 2 are grouped due to disclosure requirements.

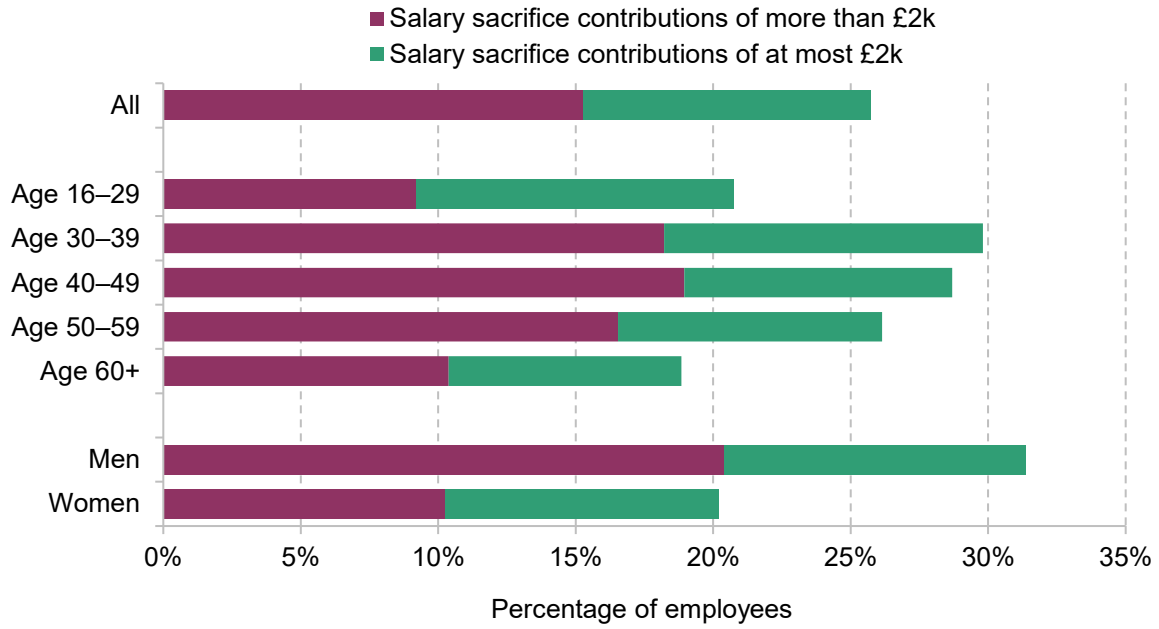
Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 2 also highlights that there is an even steeper earnings gradient in the extra NICs liabilities than in Figure 1. This is because employees in the highest decile are not only more likely to sacrifice more than the £2,000 threshold, but also more likely to sacrifice *much more* than this threshold. The bottom fifth of earners would face approximately no extra NICs under the policy, consistent with very few of this group salary sacrificing more than £2,000 into a pension. In contrast, the total average additional NICs liability for employees in the top earnings decile (and their employers) is almost £1,000 per year, mostly in the form of employer NICs. 69% of the total additional NICs liability is borne by the top earnings decile and their employers.

Figure 3 shows that employees aged 30–59 are more likely to salary sacrifice over £2,000 per year than employees younger than 30 or aged 60 and over. This is likely partly due to lower

overall pension participation rates for younger and older age groups.[8] Interestingly, employees aged 30–39 are slightly more likely to make salary sacrifice contributions than those aged 40–59. This could be because employees aged 40–59 are more likely to work in the public sector, where salary sacrifice contributions are less prevalent (as shown later on). This figure also shows that men are more likely to make salary sacrifice contributions exceeding £2,000 than women. This principally reflects the fact that women are more likely than men to be lower earners and are more likely to work in the public sector, and that these groups are less likely to be directly affected.

Figure 3. Share of employees salary sacrificing into a pension, split by whether salary sacrifice contributions are more than £2,000 per year, by age and sex



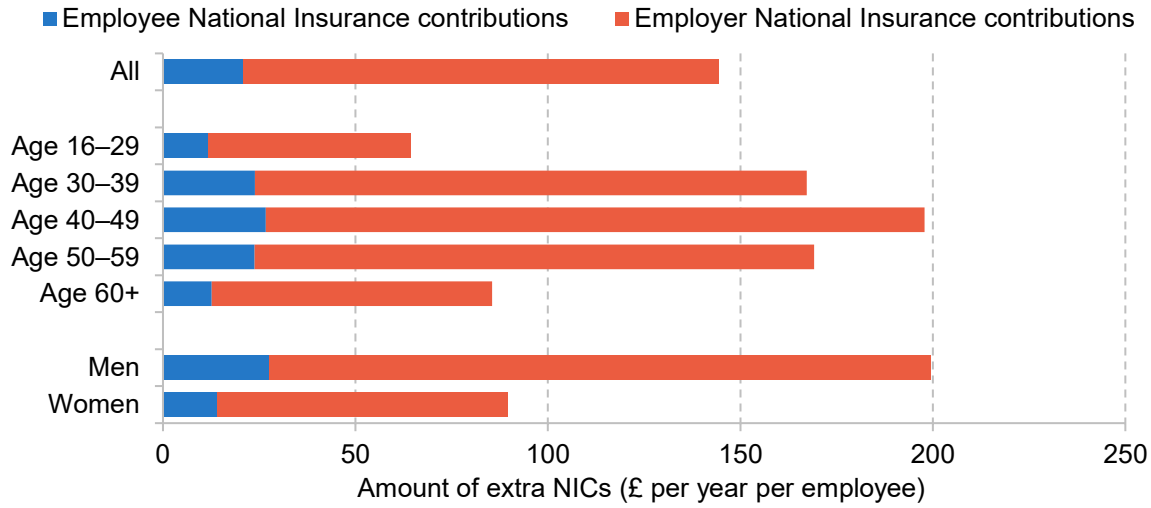
Note: We uprate earnings and pension contributions to 2029–30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings is sacrificed into pensions for employees with a salary sacrifice defined contribution pension.

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 4 shows a similar pattern in terms of the additional employee and employer NICs. The youngest and oldest employees will see a smaller increase in both their and their employers' NICs liabilities than those aged 30–59. Of course, we would expect the youngest age group of employees to increase their contributions with age, and so to be more affected by the policy when they are older. Indeed, given older workers have had many years to take advantage of tax-advantaged salary sacrifice contributions already, in the long run it is younger generations of employees who will be most affected. This figure also highlights that men and their employers will, on average, see larger tax implications from the reform than women and their employers.

[8] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/bulletins/annualsurveyofhoursandearningspensiontables/2021provisionaland2020finalresults.

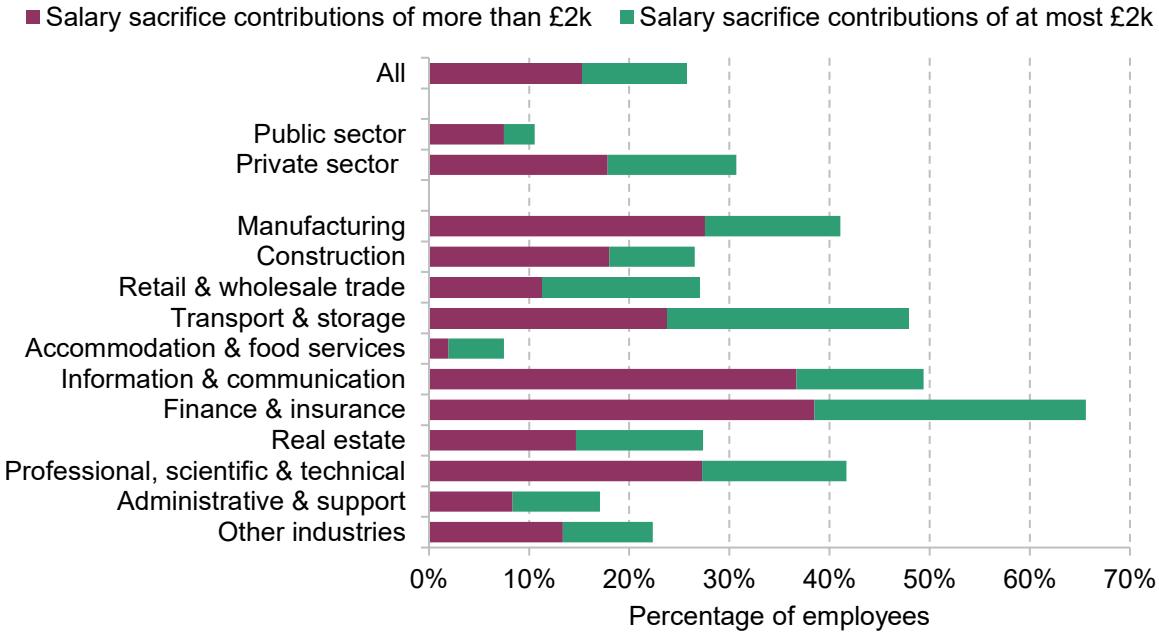
Figure 4. Mean extra yearly National Insurance contributions per employee assuming no behavioural change, by age and sex



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 is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. £2,000 threshold is in 2029–30 prices; all other £ values are in current prices. The averages are calculated over all employees, i.e. including those who are not affected by the reform (e.g. because they are not saving into a pension at all).

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 5. Share of employees salary sacrificing into a pension, split by whether salary sacrifice contributions are more than £2,000 per year, by sector and private sector industry

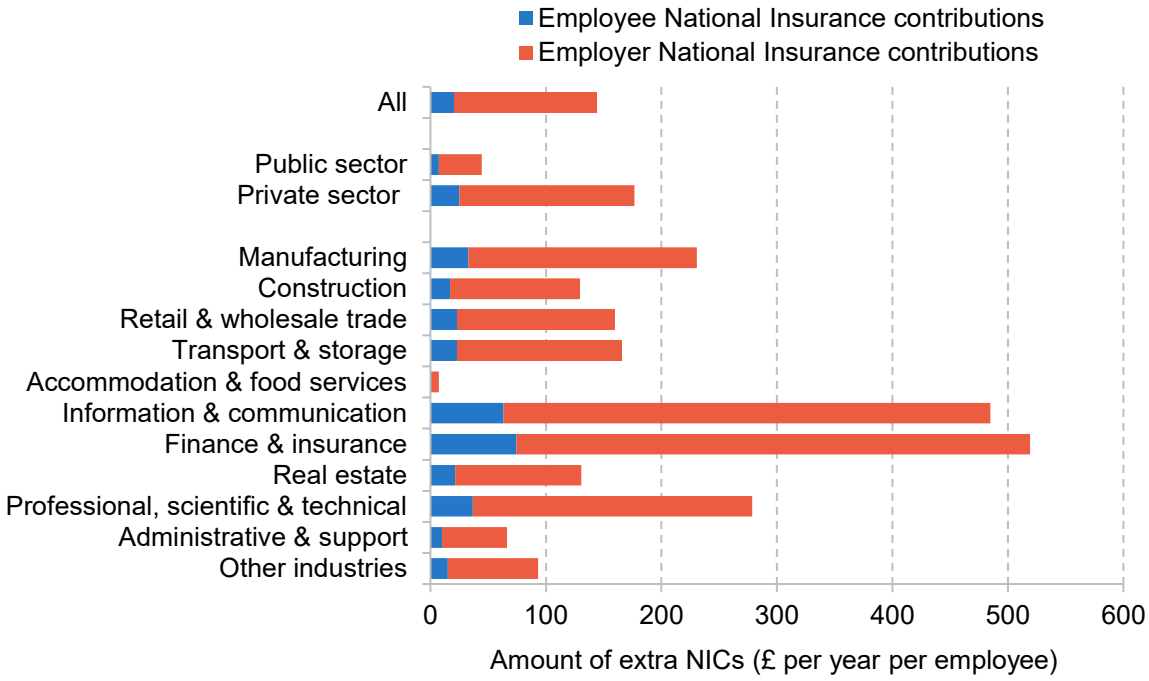


Note: We uprate earnings and pension contributions to 2029–30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. The industry split includes private sector employees only.

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 5 shows that 18% of private sector employees make salary sacrifice pension contributions of more than £2,000 per year, compared with just 7% of public sector employees. As a result, private sector employers will face a much larger average increase in NICs due to the policy than public sector employers, as shown in Figure 6. Indeed, the average yearly increase in employer NICs per employee in the private sector, £151, is over four times that in the public sector (£37), and the private sector accounts for around 93% of total additional employer NICs. This is despite the fact that pension contributions are a higher share of earnings for public sector employees than for private sector employees; however, a higher share of these pension contributions are ordinary employer pension contributions, which are not affected by the reform (Boileau, O'Brien and Zaranko, 2022). More generally, this highlights that the reform typically has less of an effect on employers that already offer higher ordinary employer pension contributions, as their employees have less need to make high salary sacrifice contributions as well.

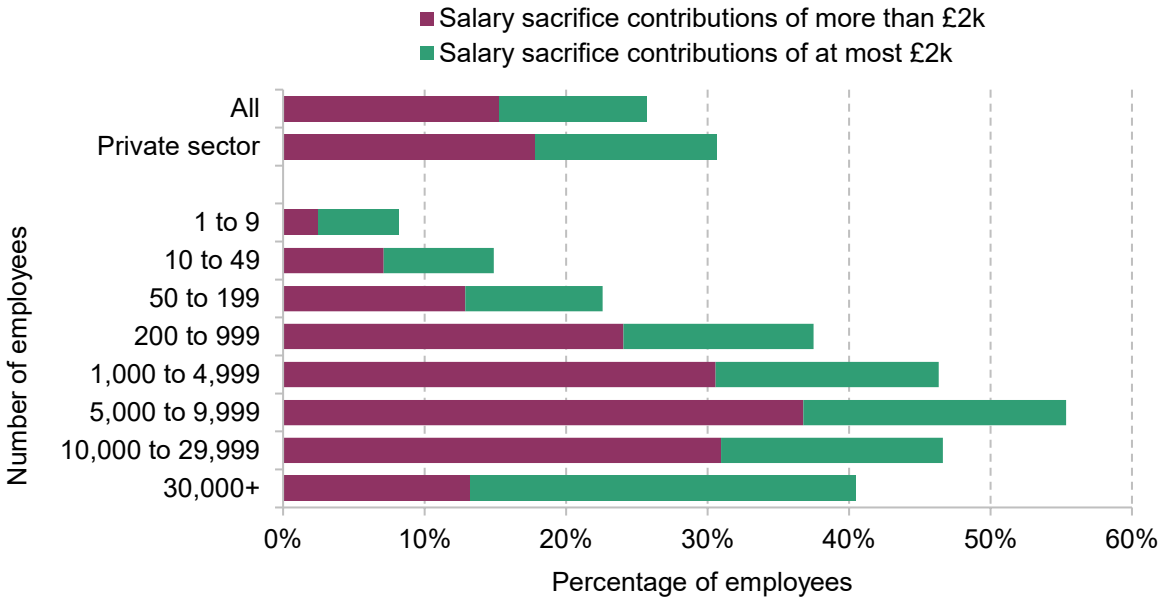
Figure 6. Mean extra yearly National Insurance contributions per employee assuming no behavioural change, by sector and private sector industry



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 is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. The industry split includes private sector employees only. £2,000 threshold is in 2029–30 prices; all other £ values are in current prices. The averages are calculated over all employees, i.e. including those who are not affected by the reform (e.g. because they are not saving into a pension at all).

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Figure 7. Share of employees salary sacrificing into a pension, split by whether salary sacrifice contributions are more than £2,000 per year, by employer size (private sector only)



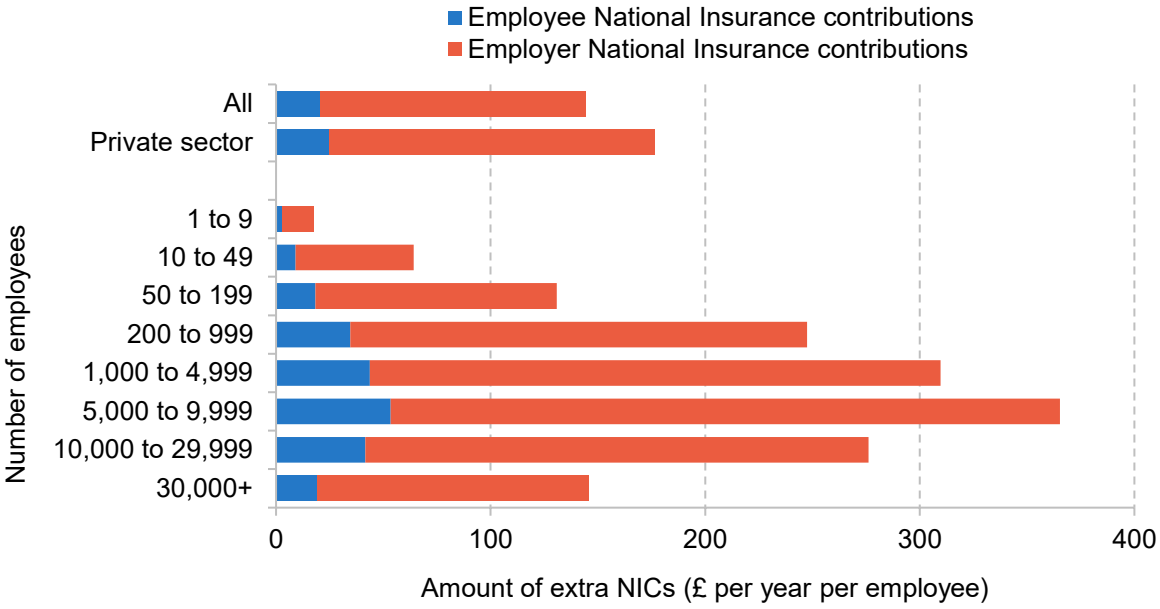
Note: We uprate earnings and pension contributions to 2029–30 using OBR data on (forecast) average nominal earnings growth. We assume that an amount equal to 47.25% of received bonus earnings is sacrificed into pensions for employees with a salary sacrifice defined contribution pension

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Within the private sector, there is substantial heterogeneity in the impact of the policy between industries, as illustrated in Figures 5 and 6. Finance & insurance and information & communication are most affected, with almost 40% of employees in these industries salary sacrificing over £2,000 per year. In contrast, employees and employers in accommodation & food services will be largely unaffected by the policy.

Figures 7 and 8 show there is an inverse u-shaped relationship between employer size and the direct impact of the reform, focusing on private sector employers. Most small employers do not operate salary sacrifice schemes, and so will be unaffected. The very largest employers, meanwhile, often have a fairly high proportion of lower-wage workers, who are less likely to sacrifice over the £2,000 threshold. As a result, employers with between 5,000 and 9,999 employees will be most affected by the reform, facing an increase in employee and employer NICs totalling around £360 per employee per year on average. These firms, and firms in finance & insurance and information & communications, will face the largest increase in costs from the policy, and may be most likely to respond by reducing remuneration and/or increasing prices.

Figure 8. Mean extra yearly National Insurance contributions per employee assuming no behavioural change, by employer size (private sector only)



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 is sacrificed into pensions for employees with a salary sacrifice defined contribution pension. £2,000 threshold is in 2029–30 prices; all other £ values are in current prices. The averages are calculated over all employees, i.e. including those who are not affected by the reform (e.g. because they are not saving into a pension at all).

Source: Authors' calculations using Annual Survey of Hours and Earnings, 2021.

Finally, we assess the distributional effects of the reform across the household income distribution, accounting for interactions with the rest of the tax and benefit system as well as for family circumstances. To do this, we use TAXBEN, the IFS microsimulation model for the UK tax and benefit system, and the 2022 Family Resources Survey (uprated to 2029–30). Since the FRS does not contain a reliable measure of salary sacrifice pension contributions, we impute these using data from ASHE and characteristics appearing in both ASHE and the FRS, including earnings decile, sex and age.[9]

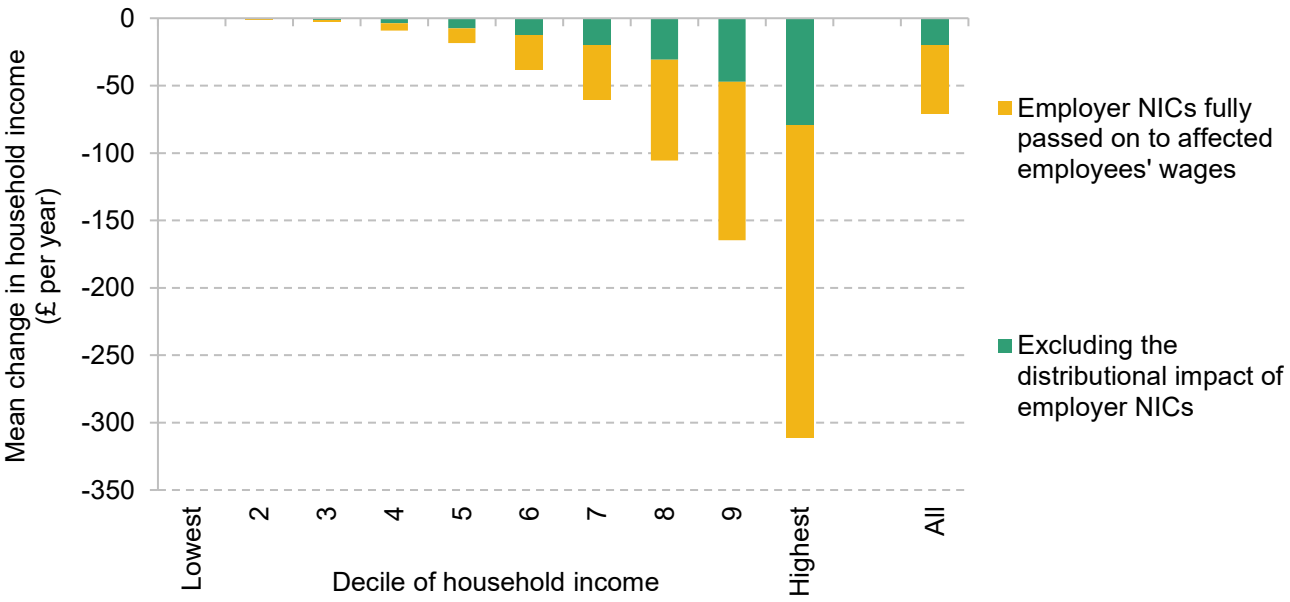
[9] The FRS does include questions about salary sacrifice pension contributions, distinct from both employee and employer pension contributions. However, our analysis revealed a substantially lower share of employees reporting having made a salary sacrifice contribution in the FRS compared with statistics from ASHE. Given that ASHE contains employer-reported data, we have more confidence in the accuracy of reported salary sacrifice pensions in this data set, which is why we impute salary sacrifice contributions in the FRS using data from ASHE. We perform this imputation in two steps. First, we use a probit regression to predict the probability of making a salary sacrifice contribution of more than £2,000 per year based on earnings decile, sex and age in ASHE. In the second step, we use a linear regression to predict the amount of salary sacrifice contributions above £2,000 based on the same regressors in ASHE. We then impute whether someone is making salary sacrifice contributions of over £2,000, and, if so, the amount of contributions over this amount, in the FRS, based on earnings decile, sex and age and the regression results from ASHE. Full details from the authors are available on request.

In order to account for the distributional effects of the additional employer NICs that result from the reform, we have to make an assumption about which households will bear the cost of the tax. Payroll taxes levied on employers ultimately have to be paid by someone: they must come off the remuneration of employees or the profits of shareholders, or be passed on as higher prices to consumers.

While it is the employer who formally pays employer NICs to HMRC, this does not mean that we would expect the tax to result only in a reduction in profits or dividends. Generally, we expect payroll taxes to be mostly paid for by the employee in the long run.[10] In other words, employers will likely respond to the increased cost principally by reducing their employees' remuneration.

However, the exact form of this reduction in remuneration, and which employees are affected, is uncertain in advance. Employers could reduce salaries or remuneration of another form, such as ordinary employer pension contributions. In addition, the extent to which the reduction in remuneration is confined to those salary sacrificing more than £2,000 into a pension, or instead shared across the broader workforce, is also hard to predict.

Figure 9. Impact on household income of salary sacrifice changes, by decile of household income



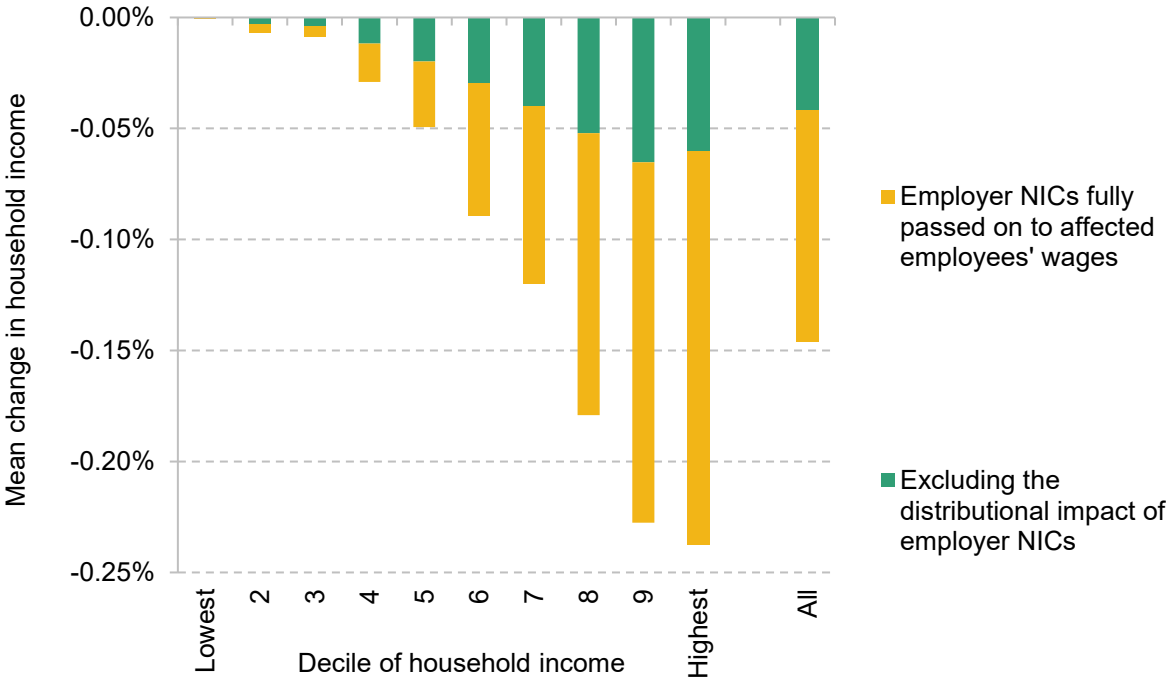
Note: Salary sacrifice contributions are imputed using 2021 ASHE uprated to 2029–30 by average earnings growth. All £ amounts are in 2026–27 prices. Deciles are calculated with respect to income, which has been equivalised (adjusted for household size).

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

[10] See https://ifs.org.uk/taxlab/taxlab-taxes-explained/national-insurance-contributions-explained for a more detailed discussion of the likely incidence of employer NICs.

In Figure 9, we show the distributional effects of the policy on household incomes. The green bars show the impact of the additional employee NICs alone (assuming that affected employees bear the full cost of these). The yellow bars show the additional impact of employer NICs, assuming that employers pass *the entirety* of their increased employer NICs liabilities on to the employees directly affected by the reform in the form of lower wages. While the actual distributional impact might differ from both these scenarios, the figure should give a good sense of the potential impact.

Figure 10. Percentage impact on household income of salary sacrifice changes, by decile of household income



Note: Salary sacrifice contributions are imputed using 2021 ASHE uprated to 2029–30 by average earnings growth. All £ amounts are in 2026–27 prices. Deciles are calculated with respect to income, which has been equivalised (adjusted for household size).

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

Overall, the cash-terms impact of the reform is concentrated on the highest decile of the household income distribution. The lowest income decile is virtually unaffected in either scenario. In contrast, the top decile of household income loses around £80 per year on average from employee NICs alone, increasing to over £300 if extra employer NICs reduce pay one-for-one. Note that this is significantly lower than the average extra NICs liability for the top earnings decile in Figure 2. This is mainly because, in these figures, we account for the fact that the reduction in pay reduces income tax and National Insurance liabilities, which mitigates the fall in income (as well as because household income deciles differ from individual earnings deciles). The vast majority of households will not be directly affected, but those who are affected will see

an average reduction in their incomes of £540. Even within an income decile, losses are quite varied. Around 65% of households in the highest decile experience no change in their income, whilst the average change among those affected in this decile is £888 per year. Figure 10 shows that the percentage impact on incomes for the highest decile of household income is greater than for any other group, though the difference is much smaller in percentage terms than in cash terms.

Both figures also once again demonstrate that the role of employer NICs is crucial. Therefore, the extent to which employers pass on this cost to their employees (rather than their customers or shareholders), and which employees they pass it on to, will be very important for influencing the overall distributional picture.

3. Conclusion

The announced reform to the National Insurance treatment of salary sacrifice pension contributions will have heterogeneous effects on different groups of employees and employers. Higher earners, men and private sector employees, especially in finance & insurance and information & communication industries, are particularly likely to be directly affected by the policy, as are their employers. The self-employed, who cannot use salary sacrifice in the first place, will not see any change in their incomes due to the direct effects of the policy.

The policy will raise a significant amount of revenue from a minority of households. The vast majority of households will not be directly affected, but those who are affected will see an average reduction in their incomes of £540 (if employer NICs are passed on completely to wages of affected workers). These households generally have high incomes; indeed, the policy is highly progressive. There are a wide range of potential ways in which individuals and employers can change their economic behaviour as a result of the policy. There is a great degree of uncertainty about the overall magnitude of these behavioural responses, and how the magnitudes will differ for different groups. This also means that there is a high degree of uncertainty around the additional tax revenue resulting from these changes.

An important question is whether the reform, ultimately, improves the overall design of how pensions are taxed. Unfortunately, it does not address the fundamental issue around the NICs treatment of pension contributions. Employer pension contributions are never subject to employee and employer NICs, a relief that cost £25.9 billion in 2023–24 (relative to a scenario where NICs were applied to these contributions, assuming they remain unchanged). This relief incentivises people and their employers to make more pension contributions, but not in a coherent way. The intensity of the incentive is linked to headline NICs rates, meaning that, for example, the significant increases in employer NICs in April 2025 increased the tax advantage of pension saving in a (presumably) inadvertent way. It is also opaque and is rarely mentioned as one of the main tax advantages of pension saving, despite its generosity. Finally, it creates a fundamental asymmetry in the tax treatment of employer and individual pension contributions. There is no clear rationale for such a large asymmetry, particularly as the self-employed, a group with especially low levels of pension saving, cannot benefit from the incentive.

The existence of salary sacrifice weakens the distinction between the tax treatments of ordinary employer contributions and of any extra contributions the individual wants to make above these. But there is still an arbitrary distinction in the tax treatment of salary sacrifice contributions and

ordinary employee contributions. And the NICs relief on salary sacrifice contributions is at least as opaque and incoherent as the relief on ordinary employer contributions.

The result of the reform is therefore to reduce one arbitrary distinction in the tax system (between salary sacrifice and employee pension contributions), while exacerbating another (between employer and salary sacrifice pension contributions). Furthermore, since tax relief will still be available below £2,000, the reform will add to the complexity of the system. Both employers and HMRC will now need to keep track of the salary sacrifice contributions an employee makes and whether they cross the £2,000 threshold.

A more ambitious reform could have raised similar revenue while improving the targeting and coherence of how the government incentivises pension saving. For example, the government could replace the total employer NICs relief of employer pension contributions with a new, less generous, subsidy for employer pension contributions, as suggested in Adam et al. (2023). This subsidy could be calibrated such that the overall package raised similar revenue to the announced reform. Compared with the announced reform, this package would reduce the asymmetry in tax treatment between employee and employer pension contributions, it would incentivise pension saving even among those groups whose earnings are currently exempt from employer NICs (such as employees aged under 21) and it would ensure that the incentive to make employer pension contributions no longer changed inadvertently with changes in employer NICs rates.[11]

In sum, the announced reform raises a significant, though highly uncertain, amount of revenue, particularly from higher earners. While it does not introduce significant new distortions to the system, it equally does not address the fundamental problems with how pension contributions attract NICs and it does add complexity.

[11] For more recommendations on what the government could do instead to improve the tax treatment of pensions, see Adam et al. (2023).

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