

# Salary Exchange and Pension Contributions (2025/26)

## Employee guide and frequently asked questions

The purpose of this Employee Guide and Frequently Asked Questions document is to provide you with some general important information on how salary exchange works when used for pension contributions. It isn't intended to give advice. It should be read alongside documentation provided by your employer, giving specific details of your pension salary exchange arrangement.

1 February 2025

Please note that the content of this booklet is based on information available as at 1 February 2025, but may be subject to change by the Government before 6 April 2025.

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# Pension Salary Exchange – An Overview

## What is salary exchange?

Salary exchange, sometimes referred to as salary sacrifice, is a contractual arrangement whereby you agree to give up part of your basic salary/earnings (your cash benefit), usually in return for your employer's agreement to provide some kind of non-cash benefit.

When used for pension contributions, you agree to exchange part of your salary/earnings in return for an equivalent pension contribution from your employer into your pension scheme. Your employer would pay this contribution in addition to any contribution they would normally make.

## What does pension salary exchange achieve?

Saving for retirement through a pension scheme has always been tax efficient. With salary exchange, it's potentially even more so.

If you pay National Insurance (NI) contributions, the reduction in your salary/earnings reduces your NI contributions. As a result, your net pay will increase but the amount of money invested in your pension scheme remains the same. Consequently, salary exchange can be a very cost-effective way of saving for your retirement.

Your employer may also save money on their NI contributions by making an additional pension contribution on your behalf (a non-cash benefit) rather than paying you your salary (a cash benefit). This saving can also benefit employees.

See 'The Advantages of Pension Salary Exchange' section on page 6 for more details.

## Further information

The amount of salary exchanged will be based upon the pension contributions you are required, or decide, to pay.

Employee pension contributions are based upon a percentage of your Pensionable Pay. Information on this, and the contribution structure for your workplace pension scheme, will be shown in the literature

provided by your employer. Please note that the amount of salary exchange will vary in accordance with changes to your Pensionable Pay.

Your salary before any exchange for pension contributions will be referred to as your Reference Salary. Please see page 9 for further information on why this is important.

## How does pension salary exchange affect my pension contribution?

The overall pension contribution to your pension scheme will not reduce as a result of pension salary exchange. Your pension contribution will still be based upon a percentage of your Pensionable Pay before salary exchange, however rather than there being an employee and an employer pension contribution, there will just be an employer pension contribution.

For example, if you pay an employee contribution of 5% of Pensionable Pay\* and your employer pays 3% of Pensionable Pay\*, under salary exchange your salary/earnings would be reduced by 5% of Pensionable Pay in exchange for your employer paying 8% of Pensionable Pay into your pension pot (the regular employer pension contribution of 3% plus an additional 5%).

The total pension contribution will be invested in the same way as before, unless you decide otherwise.

\*details of the contribution payments for your workplace pension scheme will be provided by your employer.

## Do I have to participate in pension salary exchange?

No. Salary exchange requires your agreement to change the terms and conditions of your employment contract in this way.

Pension salary exchange has many advantages, but it is not suitable for everybody, depending upon their circumstances. You should carefully consider all the information within this document and that provided by your employer to decide whether or not you wish to participate, and also for information on how to join or opt-out of your arrangement.

Please note that if you do not wish to be a member of the pension salary exchange arrangement, this will not affect your ability to be a member of the pension scheme (or an alternative company pension scheme) on a non-salary exchange basis.

## Why is there a minimum salary to participate in the pension salary exchange arrangement?

Salary exchange is not suitable for everyone. There are a number of things for you to consider when deciding whether or not to participate, however your employer has also set a minimum salary level to avoid you participating in the pension salary exchange arrangement when:

- it may not be financially beneficial for you –please see ‘What if I’m a non-taxpayer?’
- it may be detrimental to other potential forms of income
- it may cause you to reduce your pay to below the National Living/Minimum Wage

Please see the section ‘Potential Impact on Protected Pay, State Benefits and State Pension’ on page 10 for more information.

## When can I change my level of pension salary exchange?

Please refer to the information from your employer giving specific details of your pension salary exchange arrangement, on when you may change your level of pension salary exchange, and how to do this.

## How long will the pension salary exchange arrangement last?

Your employer plans to operate a pension salary exchange arrangement for pension contributions for the foreseeable future. However, if tax or NI law changes, or if it is no longer viable for your employer as a business to operate salary exchange, it reserves the right to withdraw this pension salary exchange arrangement.

Individual membership of the pension salary exchange arrangement may also be withdrawn by your employer if it is not possible to reduce your pay by the amount of your salary exchange as a result of special rules or circumstances relating to your pay.

Your employer will contact you beforehand if this applies to you. In these circumstances, you may continue to be a member of the pension scheme and employee pension contributions would be deducted from your net pay.



# The Advantages of Pension Salary Exchange

## What are the advantages to me of using pension salary exchange?

By exchanging some of your salary/earnings in return for an employer pension contribution, you are no longer receiving it as income (as a cash benefit). This means that you do not pay NI contributions on the amount exchanged.

For example, from 6 April 2025 if you earn between the Primary Threshold (£12,570) and the Upper Earnings Limit for NI contributions (£50,270) you will save 8% on the amount of salary/earnings exchanged over the Primary Threshold.

If you earn more than the Upper Earnings Limit, you will save 2% on the amount of salary/earnings exchanged over this limit.

Using salary exchange should therefore result in an increase in your take home pay when compared to paying the same employee pension contribution from your salary.

Please note that the savings achieved in subsequent tax years will depend upon NI contribution thresholds and rates, and Government policy on salary exchange arrangements.

When it comes to income tax, pension contributions paid by salary exchange are tax free because you did not receive this money as income. Alternatively, if you pay employee contributions in the usual way from your salary/earnings using the relief at source method, you will also receive income tax relief. Therefore, both methods will save you income tax. The advantage of salary exchange is that if you pay income tax above the basic rate you do not need to claim this back from HMRC through your tax return (or other method). Please refer to page 7 for more information on income tax.

For married women and widows entitled to pay reduced NI contributions, and for any employees who can defer NI contributions because they are already paying it in another job, the savings from salary exchange will be reduced.

## What are the advantages to my employer of using pension salary exchange?

Your employer wishes to have a pension arrangement that is the most simple and cost-effective way for employees to save for their retirement. By participating in pension salary exchange your employer will also save NI contributions on any salary exchanged by employees which qualifies for employer NI contributions. This is because, unlike paying a salary to employees, employer pension contributions are not subject to employer NI contributions.

A reduction in employer NI contributions can also benefit those employees in respect of whom the employer pays NI contributions and where the employer shares some of its savings. Please refer to the scheme specific document provided by your employer for details of how membership of the pension salary exchange arrangement will enable you to benefit from any employer saving in NI contributions.



# Income Tax

## What are the limits on how much I can pay into my pension and receive tax relief?

His Majesty's Revenue and Customs (HMRC) set limits on how much you can pay into a pension scheme and receive income tax relief.

In short, you can currently pay the greater of £3,600 or 100% of your annual earnings and receive income tax relief. Any contributions, including employer contributions, made above the Annual Allowance (AA) which have received tax relief will be subject to an Annual Allowance Charge.

The standard AA for the 2025/26 tax year is £60,000, however this can vary due to individual circumstances. Application of the AA can be very complicated, especially for people contributing to more than one pension scheme each year, and for those who earn over £200,000 per annum as it may be reduced by tapering (please see below).

Also, if you decide to take advantage of the flexibilities available on how benefits can be taken, which allow you to draw some or all of your benefits from your normal minimum pension age (currently age 55 for most people, but increasing to age 57 from 6 April 2028), your AA may be reduced to £10,000. This is referred to as the Money Purchase Annual Allowance ('MPAA').

If you wish to pay contributions in excess of those required by your pension scheme, please refer to the scheme specific documents provided by your employer to see how you may do this, and whether or not it can be done by salary exchange with your employer. Your employer may have placed a cap on the amount of salary exchange permissible. If you think you may be affected by the AA you should speak to a regulated financial adviser.

## Tapering of the Annual Allowance and salary exchange

High earners who are potentially affected by the tapering of the AA may wish to take financial advice before agreeing to salary exchange, as HMRC rules on this are complex. For the 2025/26 tax year the AA of £60,000 will be subject to tapering if your Threshold Income exceeds £200,000 and your Adjusted Income exceeds £260,000. The payment of employee pension contributions from your net pay can reduce Threshold Income, whereas salary exchange for employer pension contributions may not. Please see the [Annual Allowance Employee Guide](#) for further information.

## Does pension salary exchange affect how much income tax relief I receive?

If you are a taxpayer, the pension contributions you pay from your salary (the conventional method) currently receive full income tax relief provided they do not exceed limits set by HMRC. As your pension scheme gives tax relief on a relief at source basis, contributions are taken from your net pay (after income tax has been deducted).

Your pension provider will then automatically claim 20% basic rate tax relief from HMRC (a tax credit) on your behalf and add it to your pension pot. If you pay more than 20% income tax, you must reclaim the rest from HMRC.

If, instead, you use salary exchange to make your pension contributions, you give up some of your salary in return for an equivalent pension contribution from your employer. As you have not received this money as pay (a cash benefit), you will not pay income tax on it.

Consequently, both methods of contribution receive full income tax relief, but it is achieved in a different way.

## What if I'm a non-taxpayer?

Your pension provider can still receive 20% basic rate tax relief from HMRC on your behalf and pay it into your pension pot, if you pay employee pension contributions using the conventional method on a relief at source basis (from your net pay). However, if you were to use salary exchange and give up some of your pay in return for an employer pension contribution, you would not receive this tax credit.

For the 2025/26 tax year the Primary Threshold for employee NI contributions is £12,570, which is the same as the Personal Allowance for income tax. As a result, if you earn £12,570 or less you will not pay employee NI contributions on your earnings and so will not receive any NI contribution saving by being in the salary exchange arrangement. Therefore, non-taxpayers are better off paying pension contributions on a conventional basis using a relief at source method.

Your employer will have put in place provisions to prevent non-taxpayers from taking part in the pension salary exchange arrangement, such as a minimum salary level for eligibility. This is to ensure that they are not disadvantaged. Please refer to the additional documents from your employer which provide details of the eligibility requirements for your pension salary exchange arrangement.

Depending upon your circumstances, you may still be entitled to membership of the workplace pension scheme, but your contributions will be deducted from your salary using the conventional method.

## What if I am a Scottish taxpayer only paying starter rate income tax at 19%?

Currently HMRC allows your pension provider to claim 20% basic rate tax relief on your behalf and pay it into your pension pot, if you pay pension contributions using the conventional method on a relief at source basis.

You will not receive this tax credit if you use salary exchange, however for the 2025/26 tax year you will instead receive a NI contribution saving of 8% on the amount of pay given up over the Primary Threshold (which for the 2025/26 tax year is £12,570). This is in addition to not paying starter rate income tax at 19% on the amount of pay given up over the PAYE tax threshold, which is £12,570 for 2025/26 tax year.

## What if I pay income tax above the basic rate of 20%?

HMRC currently allows you to receive income tax relief at your full marginal rate, provided your total contributions do not exceed their limits.

If you pay income tax above the basic rate of 20%, paying employee pension contributions from your

salary using the conventional method (from net pay on a relief at source basis) will result in your pension provider automatically claiming 20% basic rate income tax relief from HMRC on your behalf and adding it to your pension pot. Any further tax relief you may be entitled to will have to be reclaimed by you through your self-assessment, or by contacting HMRC to adjust your tax code.

One of the benefits of pension salary exchange is that it effectively avoids the need to claim additional tax relief. This is because by giving up some of your salary (a cash benefit) in exchange for an employer pension contribution (a non-cash benefit), you do not pay any income tax on the amount in the first place.

If you have claimed additional tax relief in the past, it is possible that your tax office has increased your tax code to effectively give you your higher rate relief at source on pension contributions. If this is the case and you decide to participate in the salary exchange arrangement, you will need to contact your tax office to reduce your tax code, otherwise you will be receiving too much tax relief.

If you are a higher rate taxpayer but have not claimed additional tax relief, you may be due a tax rebate. In this instance you will need to contact your tax office, giving them details of your contribution history from your pension provider to evidence your claim.



# Pension Salary Exchange and Other Earnings Related Employment Benefits

## Does pension salary exchange affect any other benefits provided by my employer?

Although your gross salary/earnings will be reduced, your employer will commonly use your Reference Salary (sometimes also called your Notional Salary) to calculate any salary-based benefits.

Your Reference Salary is your annual salary before the exchange is applied, and is often used in the following situations:

- when determining an increase to salary
- to work out entitlement to holiday pay and sick pay
- for life insurance and permanent health insurance
- to calculate any bonus payment (if applicable)

Please refer to the pension salary exchange arrangement specific documents provided by your employer for specific details of when your employer will use your Reference Salary.

## Will pension salary exchange impact any bonus payments made to me?

The way any bonus payment is calculated is determined by your employer. Please refer to the information from your employer giving specific details of your pension salary exchange arrangement for details of whether salary exchange will affect any bonus payment made.

## Will pension salary exchange affect my Statutory Redundancy Pay if I get made redundant in the future?

If, at any point, you become entitled to Statutory Redundancy Pay, this may be reduced as it is based on earnings which have been reduced by pension salary exchange.

Please refer to your terms and conditions of employment concerning your entitlement to redundancy pay. In addition, please also refer to the pension salary exchange arrangement specific documents provided by your employer, for information on how your employer will calculate any entitlement you may have to redundancy pay where salary exchange has taken place.

## How will pension salary exchange affect any mortgage application?

When your employer gives a mortgage reference to support your application, they can confirm your Reference Salary, which is your salary before it is reduced by pension salary exchange. However, there is no guarantee that this will be accepted by all lenders when determining the maximum amount you may borrow. You should therefore discuss this directly with your mortgage lender.



# Potential Impact on Protected Pay, State Benefits and State Pension

Pension salary exchange can have implications for employees beyond their pension contributions and workplace benefits.

Please note that Mercer Marsh Benefits are not specialists in this area. We recommend that you take independent advice from the relevant organisations and you obtain your own legal, tax and/or financial advice as applicable on any matters which concern you.

## Can pension salary exchange take me below the National Living/Minimum Wage?

Exchanging your salary in return for an equivalent employer pension contribution, cannot result in your remaining pay being less than the National Living Wage (if you are aged 21 or over) and the National Minimum Wage (if you are aged under 21).

From April 2025:

- The National Living Wage is £12.21 an hour for all those aged 21 or above;
- The National Minimum Wage is:
  - £10.00 an hour for those aged 18 to 20;
  - £7.55 an hour for under 18's (but above compulsory school leaving age); and
  - £7.55 an hour for Apprentices aged under 19 and Apprentices aged 19 and over, but in the first year of their apprenticeship.

If this applies to you, you will not be able to participate in the pension salary exchange arrangement. Please refer to the scheme specific document provided by your employer for the eligibility criteria for your pension salary exchange arrangement.

Please note that if you also participate in any other salary exchange arrangement (e.g. a childcare voucher scheme which you have been a member of since before 4 October 2018, or a cycle to work scheme) then the amount of salary exchanged in that arrangement would also be taken into account when assessing your remaining pay for National Living Wage and National Minimum Wage purposes.

## Will pension salary exchange affect my entitlement to tax/universal credits?

If you currently receive tax credits or universal credits, you should speak to your tax credits office before you decide whether to participate in a pension salary exchange arrangement. You must also notify your tax credits office once you have exchanged your salary and of any future changes to the amount exchanged.

## How does pension salary exchange affect child benefit payments?

You may have to pay a tax charge, known as the 'High Income Child Benefit Charge' if you have an individual income over £60,000. The tax charge is 1% of the child benefit paid for every £200 of adjusted net income between £60,000 and £80,000 i.e. child benefit is lost if adjusted net income is £80,000 per annum or more. Adjusted net income is income net of pension contributions, therefore pension contributions are taken into account whether you pay them using salary exchange or through your net pay. Consequently, your eligibility for child benefit should not be affected by taking part in the salary exchange arrangement for pension contributions.

Further information on child benefit can be found here - <https://www.gov.uk/child-benefit>

## How does pension salary exchange affect State benefits?

If you are in receipt of State benefits or Statutory Payments, or think you may be in receipt in the near future, you should contact the relevant benefits office before joining the pension salary exchange arrangement to clarify whether or not it may affect your eligibility for benefits and the payments. Please note that Mercer Marsh Benefits are not specialists in this matter.

## • Contribution based benefits

Entitlement to some State benefits such as the 'new style' Jobseeker's Allowance and the new State Pension, is linked to the amount of NI contributions that you have paid, or if you have received NI contribution credits.

In order not to detrimentally affect your NI contribution record, your earnings need to be at or above the Lower Earnings Limit, which for 2025/26 is £125 per week, £542 per month and £6,500 per year. If your earnings were to fall below this level due to pension salary exchange, your entitlement to contributory State benefits and the new State pension may be detrimentally affected if you do not receive NI contribution credits in another way.

## • Statutory Pay

You also need to be earning more than the Lower Earnings Limit to qualify for statutory payments such as Statutory Sick Pay and Statutory Maternity Pay. Therefore, your eligibility for these benefits would be detrimentally affected if your pay were to fall below the Lower Earnings Limit.

In order not to jeopardise your entitlement to contributory State benefits, the new State pension and, where relevant, statutory payments, you will not be allowed to participate in the pension salary exchange arrangement if your income is close to, or below, the Lower Earnings Limit. Please refer to the scheme specific document provided by your employer for details of the eligibility criteria for your pension salary exchange arrangement.

It should be noted that, even if you are entitled to receive Statutory Pay because your earnings remain above the Lower Earnings Limit (and you satisfy any other criteria), the amount of the payment may be affected by a reduction in your pay caused by salary exchange. This is because some payments are calculated as a percentage of your pay. You should check the specific rules concerning any statutory payments which may affect you.

## How does pension salary exchange affect Statutory Maternity Pay and pension contributions?

Eligible employees are entitled to up to 52 weeks of Statutory Maternity Leave (SML) to have (or adopt) a child.

Statutory Maternity Pay (SMP) is paid for up to 39 weeks to those employees who meet the qualifying criteria.

SMP is calculated as 90% of your average weekly earnings (before tax) for the first six weeks. If you are in the pension salary exchange arrangement, this calculation will be based upon your pay after the salary exchange has taken place, and consequently will be lower.

The remaining 33 weeks will be paid as the lower of:

- 90% of your average weekly earnings (before tax)
- £187.18 per week for the 2025/26 tax year

Therefore, salary exchange will only impact on the SMP payments made in the remaining 33 weeks if it takes 90% of your average weekly earnings (before tax) to below £187.18 (i.e. if it results in your total average weekly earnings (before tax) being below £207.98).

During paid maternity leave your employer is required to contribute to your pension scheme based on your normal salary, i.e. the salary you would be receiving if you were not on maternity leave. If you are not in the pension salary exchange arrangement, you would be required to pay pension scheme contributions on your actual pay during this period.

If you are in receipt of SMP, this will not be reduced by the amount of your salary exchange, however your employer will continue to pay the full pension contributions into the pension scheme, based on your pre-maternity (pre-exchange) salary, for the length of your paid maternity leave.

Your employer may also have a maternity policy and your contract of employment may make additional provision for paid maternity leave. This may allow for salary exchange deductions to continue from any enhanced maternity pay over SMP in the same way as if you were working, with NI contribution savings as applicable. You should refer to your contract of employment in this instance.

## Paternity Pay and Shared Parental Leave

Please note that Statutory Paternity Pay and Statutory Shared Parental Pay are also calculated at the rate of £187.18 a week (2025/26 tax year) or 90% of your average weekly earnings if lower.

It is not possible to provide a comprehensive guide to maternity, paternity and shared parental pay in this FAQ, and Mercer Marsh Benefits are not experts in this area. For further information please contact your employer or go online at [www.gov.uk](http://www.gov.uk)

## Other Issues to Consider

Please note that Mercer Marsh Benefits are not specialists in this area. We recommend that you take independent advice from the relevant organisations and you obtain your own legal, tax and/or financial advice as applicable on any matters which concern you.

### Will there be any impact on my student loan deductions if I move to pension salary exchange?

Student loan deductions are calculated based upon your gross pay, which will be reduced by the amount of pay you have exchanged in return for an employer pension contribution.

Essentially, based upon the type of student loan that you have, deductions are made on earnings over a certain threshold. Consequently, reducing your gross pay through pension salary exchange may take you below the relevant student loan repayment threshold, or reduce the amount of your pay above this threshold when calculating how much you must repay. As a result, it may take you longer to repay your student loan.

If you have any student loans you should fully consider the implications of pension salary exchange on your ability to repay your student loan, including the terms and conditions of your loan. You may wish to obtain financial advice.

The following link may also be helpful.  
<https://www.gov.uk/repaying-your-student-loan>

### Will taking part in pension salary exchange have any impact on my child maintenance payments, or any payments made as a result of an Attachment of Earnings Order (AEO)?

The rules surrounding child maintenance payments and AEOs can be complex. If this applies to you, you should review the terms and conditions of any agreements made and seek advice to clarify how taking part in a pension salary exchange arrangement will affect you personally.

### Should I join the pension salary exchange arrangement if I am over State Pension Age and so do not pay NI contributions?

This is entirely your decision. If you are over State Pension Age you will not pay NI contributions on your earnings and so you will not see any change in your take home pay by participating in a pension salary exchange arrangement. Depending upon your decision, and how your employer is implementing the pension salary exchange arrangement, you may need to either opt-in or opt-out of the arrangement.

As your employer is sharing some of its saving in NI contributions you can still benefit from being in the salary exchange arrangement even though you do not pay your own NI contributions.

Please refer to the scheme specific documents provided by your employer for more information regarding your pension salary exchange arrangement and how it affects you.

## Where can I obtain support and guidance on pensions?

The Money and Pensions Service (MaPS) is sponsored by the Department for Work and Pensions.

<https://maps.org.uk/en/about-us/who-we-are>

MaPS has introduced a service called MoneyHelper to provide information and free guidance to people of all ages on financial issues including pensions and retirement.

<https://www.moneyhelper.org.uk/en>

If you are aged 50 or over, you can get free and impartial guidance through Pension Wise, which is part of MoneyHelper. Telephone or online appointments are available and can be arranged by visiting their website at:

<https://www.moneyhelper.org.uk/en/pensions-and-retirement/pension-wise>

Alternatively, you can call 0800 138 3944

If you are under 50 you can still get pensions guidance by calling 0800 011 3797 or by visiting the MoneyHelper website shown above.

Please note that MaPS and MoneyHelper will not be able to give you advice on, or recommendations specific to, your circumstances.

If you need specific advice on your options or financial circumstances, you will need to speak to a regulated financial adviser, who will normally charge you a fee.

MoneyHelper provides information on how to find a financial adviser in the following links:

<https://www.moneyhelper.org.uk/en/pensions-and-retirement/taking-your-pension/use-our-tool-to-find-a-retirement-adviser>

<https://www.moneyhelper.org.uk/en/getting-help-and-advice/financial-advisers/choosing-a-financial-adviser>



## Important Notices

The salary exchange arrangement is entirely discretionary and can be withdrawn or amended by your employer at any point of time.

Please note that the onus is on the employee to decide whether salary exchange is right for them.

The information provided above provides a brief overview of salary exchange, and is based on our current understanding of legislation, taxation law and HMRC practice, which may change in the future, for example if Government policy changes. Please note that the tax and National Insurance contribution rates shown in this document are for 2025/26, and are correct as at 1 February 2025.

Please also note that we are not lawyers or tax advisers and nothing in this document should be construed as legal or tax advice or relied on for this purpose. We strongly recommend that you seek appropriate advice in relation to matters of law and taxation.

This document is for information only and is not personal financial advice. If you require financial advice you should seek this from a regulated financial adviser.

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