

**Paying unused employer
contributions as additional
salary (recycling
contributions)**

Where employees have opted out of the NHS Pension Scheme for tax reasons, employers may introduce a policy to pay any unused employer contributions as additional salary. This is often known as recycling contributions.

The NHS Pension Scheme is a key part of the reward offer for employees in the NHS. Recycling unused employer contributions may be considered necessary to recognise the fact that staff who have opted out of the scheme due to pension tax issues will not get the full value of benefits from their employer's pension contribution in comparison to other colleagues. These payments are one way to restructure the employee's total reward package in order to maintain its value. Such a policy could help protect the delivery of services by encouraging employees to continue working in the NHS for longer.

Employers are under no obligation to offer unused employer contributions as additional salary. It is the employer's decision whether or not to implement a contribution recycling policy, based on the needs of their organisation.

Legal risks for employers to consider

There are some legal risks that employers should consider when deciding whether or not to introduce a recycling policy. This section explains the actions employers can take to mitigate some of these risks.

Managing equality risks

Employers should consider the impact of a contribution recycling policy on pay equality and the gender pay gap, particularly where contribution recycling is offered to one group of staff and not others. As an example,

from the policy. This may create a risk of equal pay claims or claims of discrimination (most likely indirect discrimination) on the grounds of age or sex.

Employers can mitigate the risk of a successful equal pay or a discrimination claim by:

- using an equality impact assessment to assess potential implications of introducing the policy
- having a strong justification for introducing the policy.

This helps to establish a 'material factor defence' in respect of an equal pay claim and that the policy was a 'proportionate means of achieving a legitimate aim' in respect of a discrimination claim.

For example, if an employer has evidence to show that senior clinicians or managers are leaving or reducing their commitments due to pension tax concerns, they may decide to introduce a recycling policy to retain senior employees who may otherwise leave the NHS. The employer can argue that the retention of senior clinicians or managers was the legitimate purpose of the policy, and that it was proportionate to ensure the retention of these employees.

Ensuring compliance with automatic enrolment duties

Employers could potentially face a challenge that their contribution recycling policy acts as an incentive for employees to leave the NHS Pension Scheme. Under the automatic enrolment regulations, set out in the Pensions Act 2008, employers should not take 'any action for the sole or main purpose of inducing a worker to give up membership of a relevant scheme without becoming an active member of another relevant scheme'.

How employers can mitigate the risk of breaching their automatic enrolment duties

When determining whether there has been a breach of automatic enrolment duties, The Pensions Regulator (TPR) will look at the motivation of the employer. A breach can only occur if the purpose of the policy was ‘for the sole or main purpose’ of inducing staff to opt out of the scheme. Clear evidence and justification that the scheme has been introduced with the aim of retaining senior clinicians, managers and key decision makers to protect the delivery of services would demonstrate that it was not introduced for the sole or main purpose of inducing staff to leave the NHS Pension Scheme.

Offer an alternative pension scheme.

Employers cannot breach the Pensions Act 2008 if the employee has the opportunity to become ‘an active member of another relevant scheme’, for example, NEST. It is therefore important that employers offer alternative scheme membership to those opting out of the NHS Pension Scheme as part of discussions with employees about contribution recycling.

Ensure all employees who are not active members of the NHS Pension Scheme are assessed against the automatic enrolment criteria and automatically enrolled into the NHS Pension Scheme, where appropriate, at the employer’s next automatic re-enrolment date.

If this guidance is followed, the likelihood of breaching the automatic enrolment duties and the impact on the employing organisation would be low.

There is no freestanding right for an employee to bring a claim for a breach of the automatic enrolment rules. If TPR investigated a potential breach, and if a breach is found to have occurred, TPR would contact the employer and ask the organisation to take steps to comply with their duties. TPR may impose a fine of up to £50,000 if the employer ignores their duties or does not act on TPR’s direction.

Managing public money

principles set out in paragraph 5.6.1 of Managing Public Money in relation to tax avoidance.

Key points for employers to include when creating a policy

Employers that have decided to offer recycling of unused contributions should have a policy in place for this. This section covers the points employers should include when developing a local policy. We would encourage employers to seek input from local staff side representatives as part of this process.

- The justification for introducing the policy should be clearly set out. This may help to manage potential equality risks.
- The policy should explicitly state that the arrangement does not form any contractual entitlement and the employer has the discretion to review, amend or remove the policy at any time through consultation and using appropriate notice periods.
- There should be a statement to confirm that the employer has strongly encouraged employees to take independent financial advice to assess if opting out of the NHS Pension Scheme is in their best financial interests.

Employers may wish to signpost staff to our list of independent financial advisors.

- The policy should highlight the impact of opting out of the scheme on the employee's entitlement to death in service and ill-health retirement benefits.

If an employee dies or or retires due to ill health whilst not actively contributing to the scheme, a lower level of benefits is payable. This is outlined in our briefing document and further information is available on the NHS Pensions website. Individuals may wish to consider setting up alternative insurance cover away from the NHS Pension Scheme.

- Employers will need to decide locally which members of staff will be eligible to receive the additional salary payments. The policy should clearly set out how employees will need to satisfy their employer that they are eligible to receive the additional payments. For example, they may be required to provide evidence that they are affected or are likely to be affected by the annual allowance and / or lifetime allowance and that they have opted out of the scheme. This could be in the form of a letter from the employee's independent financial adviser or a statement from NHS Pensions. Employees would need to give their employer sufficient notice if they decided to opt back in to the NHS Pension Scheme, meaning they were no longer eligible for the additional payment.

Employers will need to consider the position of staff who opted out of the NHS Pension Scheme due to tax reasons before the policy was introduced and how they intend to respond to any claims for retrospective or backdated payments.

- The policy should include details of the alternative pension scheme offered to staff. Offering an alternative scheme helps to mitigate the risks of breaching automatic enrolment legislation and offers increased flexibility to the individual over their future pension saving
- Employers will need to clarify the value of additional salary payments available to eligible staff under the policy.

The employer contribution rate increased in April 2019 from 14.3 per cent to 20.6 per cent of pensionable pay (plus the 0.08 per cent scheme administration levy). The government agreed to provide funding for employers to cover this increase in cost. An interim funding arrangement is currently in place under which the employer pays 14.38 per cent to the NHS Pension Scheme and the additional 6.3 per cent is paid directly to the scheme from NHS England and Improvement. Employers do not currently have access to this additional 6.3 per cent of contributions. If employers offer to pay employer contributions above 14.38 per cent to

staff as salary, this will represent a cost pressure to employers whilst this interim funding arrangement is in place.

(NICs) payable in respect of the individual. From 1 April 2022, this increase is approximately equal to 15.05 per cent of the value of any additional salary payments and should be taken into consideration when calculating the amount paid to an employee in order to keep this cost-neutral. The table below shows how employers can pay up to 14.38 per cent of an individual's pensionable pay to staff as additional salary on a roughly cost-neutral basis, taking into account the increase in employer NICs.

Employers should review the level of payments provided to staff at least annually, to take into account any future changes to the employer contribution rate, National Insurance rates and funding arrangements.

	Member of the NHS Pension Scheme	Employee who has opted out and is receiving employer contributions as additional salary payments.
Pensionable earnings	£100,000	£100,000
Amount paid to NHS Pensions from the employer (14.38%)	£14,380	£0
Additional employer NICs* (from 1 April 2022)	£0	£1,881
Extra taxable amount paid to employee in lieu of pension	£0	£12,499

	Member of the NHS Pension	Employee who has opted out and is receiving employer contributions as additional salary payments
--	----------------------------------	---

are only payable in respect of earnings above the secondary threshold and so the correct value of the employer NICs would be slightly lower than shown in the example. Please see the HMRC website for more information.

- Staff will need to make a request under the policy to receive the additional payment. This process should be set out in the policy, having been approved by the board of directors and overseen by the remuneration committee.
- Employers should review the policy regularly and monitor uptake to ensure that it still meets the needs of the organisation.