

Pension tax guidance for employers

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Introduction

Staff who have concerns about pension tax charges may feel they need to take action to limit their pension growth. Examples of the actions that staff may consider include:

- reducing working hours
- avoiding any additional paid responsibilities
- opting out of the scheme, either permanently or temporarily for part of the tax year
- taking their pension and leaving NHS employment
- retiring and returning to work, often with lower working hours.

Many of these actions will lead to a reduction in clinical capacity and will have an impact on service delivery.

Experienced senior clinicians and managers are more likely to earn pension benefits that may exceed the annual allowance. Retention of these members of our workforce is key to addressing pressures on service delivery.

Our guidance covers the local options employers can put in place to support staff who are facing pension tax issues. The following arrangements may help support staff to continue to work in the NHS for longer and ensure they feel valued, rewarded and appreciated for the work they do:

Paying unused employer contributions as additional salary (recycling contributions)

We explore the legal risks employers should consider when deciding whether to introduce a recycling policy and the actions employers can take to mitigate some of those risks.

Using multiple contracts of employment

We consider how establishing multiple part-time contracts of employment in place of a single full-time contract of employment can enable employees to opt out of the NHS Pension Scheme for one or more of their employments to reduce the value of pension benefits they build up over the year.

Managing pensionable pay

We outline the existing flexibilities which may allow employers to determine certain elements of pay as being non-pensionable to help staff to limit their pension growth.

Opting out of the scheme for part of the year

We highlight the points employers should consider where employees choose to manage their pension growth by opting out of the NHS Pension Scheme for a period of time during the scheme year.

The importance of financial advice and guidance

Before putting any of these local arrangements in place, employers should strongly encourage employees who are concerned about their pension tax position to seek independent financial advice to:

- check the employee is actually at risk of exceeding their annual allowance
- understand if it is in the employee's best financial interests to take any action to limit their pension growth.

It is vital that employees take independent financial advice before making any decisions to change their working patterns or opt out of the NHS Pension Scheme.

In some cases, it may be financially beneficial for individuals to continue to work and build up pension in the scheme and pay any tax charge that falls due.

Options such as carry forward or scheme pays may be appropriate ways for the individual to manage and pay their tax liability.

An individual's pension tax position depends on their own financial circumstances, such as their length of membership in the NHS Pension Scheme, their pay progression, their taxable income from all sources (including income from employment outside the NHS and rental

properties) and their pension savings from all employments. This means the most appropriate course of action for one employee is not necessarily the same for another.

A list of organisations that can give expert guidance and advice on pension tax issues for members of the NHS Pension Scheme is available on our website.

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.

As the lifetime allowance (LTA) was removed with effect from the 2023/24 tax year, LTA only recycling schemes no longer have a purpose. Annual allowance (AA) was also increased from £40,000 to £60,000 with effect from the 2023/24 tax year, effectively reducing the number of staff who will be affected. Staff who may still be affected or be affected by the tapered annual allowance may benefit from targeted support. [To learn more about changes to pension tax, read our briefing, what the Spring 2023 budget means for pension tax and retention.](#)

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, where recycling contributions is offered only to staff affected by pension tax issues, it is possible that older male employees would benefit most 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

Have a strong justification for introducing the policy.

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

Employers should ensure that their finance directors are comfortable that any policy to recycle unused employer contributions complies with the 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 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 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 2024 from 20.6 per cent to 23.7 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 9.4 per cent is paid directly to the scheme centrally. Employers do not currently have access to this additional 9.4 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.

The payment of additional salary in lieu of scheme membership will lead to an increase in the cost of the employer National Insurance contributions (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
Total employer cost	£114,380	£114,380

*In this simplified example, the increase in employer NICs has been calculated based on a flat rate of 15.05 per cent. In reality, employer NICs 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.

Using multiple contracts of employment

Employees with multiple part-time contracts of employment can opt out of the NHS Pension Scheme for one or more of their employments to reduce the value of pension benefits built up over the year. For full-time employees, employers have the option to split the full-time contract into two part-time contracts.

The distribution of pensionable and non-pensionable pay across both contracts can be varied to manage pension growth. Both the ESR payroll system and the scheme regulations are already set up to deal with employees with multiple part-time employments.

Unlike the approach of opting out of the scheme for part of the year, this option has the advantage of retaining the death in service and ill-health retirement cover provided by the NHS Pension Scheme for the whole scheme year, as the employee will still be a member of the scheme in at least one of their contracts. However, any benefits would be at a lower level, based on the part-time salary.

Key considerations for employers

Contract management

Employers should be aware of the potential practical issues of having to manage different contracts. The employer may need to close the existing contract of employment and issue two or more new separate contracts of employment. The potential impact that termination of one contract may have on the other contract should also be considered (for example, due to redundancy or disciplinary purposes).

Opting out of the scheme

The process of opting out is still required under the regulations as contracts of employment are always pensionable. Employers will also need to follow ongoing automatic re-enrolment requirements

Income tax

Members should be aware that they will pay more income tax on their salary due to paying lower pension contributions. This may be offset by a reduction in an annual allowance tax charge.

Final pay controls

Employers may wish to seek guidance from NHS Pensions about whether a final pay control charge will be incurred if the employee reverts to their original contract before retirement

Managing pensionable pay

Determining certain elements of pay as being non-pensionable may help staff to limit the value and rate of their pension growth. Individuals with lower pensionable pay will build up a lower pension and will be less likely to breach the annual allowance.

Employers have some flexibility in determining what pay is pensionable, depending on the nature and duration of the payment.

Employers must comply with the NHS Pension Scheme regulations that define pensionable earnings.

- For staff employed by NHS organisations, pensionable earnings are broadly all salary, wages, fees and other regular payments.
- Non-pensionable payments include bonuses, non-regular payments, payments made to cover expenses or overtime and pay awards or increases which are expressed by the Secretary of State to be non-consolidated.

Further information about which payments are pensionable and non-pensionable is available on the NHS Pensions website.

Potential flexibilities in determining pensionable pay

Employers may wish to discuss the existing flexibilities around the following payments:

Temporary payments

Most temporary payments are non-pensionable. Exceptions include temporary pay increases and shift allowances.

Local payments

Most local payments can be determined as non-pensionable. Payments in national contracts such as London weighting are pensionable.

One-off payments

Employers may wish to explore options to establish non-pensionable one-off bonus payments in recognition of the completion of additional activity.

Overtime

All overtime payments are non-pensionable for full-time staff, unless they have taken partial retirement within the last 12 months. Overtime for part-time staff is pensionable up to the whole-time standard week, if paid at the basic hourly rate.

Additional programmed activities (PAs)

Additional PAs which exceed the standard contractual limit of 10 are non-pensionable. Employers should ensure job planning processes and any

supporting documentation clearly sets out that additional PAs are over and above the standard contract and are subject to regular review.

Allowances for undertaking management responsibilities

Payments will be pensionable if the management responsibility is linked to one of the 10 PA's in a consultant's job plan or if the responsibility is taken on in addition to the job plan but without any additional time being allocated to this work. Payments made on a regular and continuing basis will be pensionable. This applies to both part-time and whole-time employees.

Allowances will be non-pensionable if they are linked to a non-pensionable PA that exceeds the standard contractual limit of 10 or if they are temporary and subject to review.

Employers may wish to bear this in mind when working with individuals to agree their job plan. If additional management responsibilities increase actual working time above 40 hours per week, this extra time worked will also be non-pensionable. If part-time staff are required to work additional PAs due to the additional responsibility, these PAs will be pensionable up to whole-time, but anything above this will be non-pensionable.

Waiting list initiative (WLI) payments

Additional paid waiting list activity that is voluntary and in addition to contracted hours is a form of overtime and is pensionable up to whole-time. WLI payments should be non-pensionable if the activity exceeds whole-time or if the payment is made as a one off bonus.

Weekend and on-call payments

Availability allowance for on-call work is only pensionable if there is a specific rota commitment that an individual is paid for on a regular basis.

This applies to both part-time and whole-time employees. Payments for work completed above whole-time whilst on call are non-pensionable.

Local Clinical Excellence Awards (LCEAs)

New LCEA payments made from 1 April 2018 are non-pensionable, as they are non-consolidated and re-earnable, whereas existing LCEAs will remain pensionable. There is scope for employers to convert existing LCEAs into new LCEAs by agreement with the employee and the Joint Local Negotiation Committee (JLNC).

Key considerations for employers

Pension tax matters are very specific to the varying circumstances of each individual and the nature of the payment. We would therefore encourage employers to discuss pensionable pay arrangements with staff individually to reach an appropriate agreement. Any measures that are put in place should be reviewed regularly to ensure the arrangements remain appropriate for the individual and the employer. We would advise that employers set a review date when agreements are made.

Annual allowance taper

Non-pensionable payments still count towards an individual's threshold income and adjusted income, which determine whether the employee will have a lower, tapered annual allowance. See our [annual allowance briefing](#) for more information about the tapered annual allowance.

Impact on benefits in retirement

Limiting pension growth by reducing pensionable earnings will lead to lower pension benefits in retirement.

Income tax

Members should be aware that they will pay more income tax on their salary due to paying lower pension contributions. This may be offset by a reduction in an annual allowance tax charge.

Opting out of the scheme for part of the year

Some employees are choosing to manage their pension growth by opting out of the NHS Pension Scheme for a period of time during the scheme year and then returning to the scheme.

Key considerations for employers

Independent financial advice

Employers should strongly recommend that employees take independent financial advice before opting out of the NHS Pension Scheme. Employees will need advice to understand the optimum value of pension they should earn during the year and the precise point at which they should opt out and re-join the scheme. Members should also be aware that they will pay more income tax on their salary due to paying lower pension contributions. This should be considered in conjunction with the value of pension gained and any benefit from lower annual allowance tax charges.

Family protection benefits

Employers should ensure staff are aware that they will not be fully covered for death in service and ill-health benefits provided by the NHS Pension Scheme during the part of the year in which they are not an active member of the scheme. If an employee were to pass away or retire due to ill health during a period where the employee had opted out of the scheme a lower level of benefits would be 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 cover away from the NHS Pension Scheme.

Recycling employer contributions

Employers will need to consider if any unused employer contributions could be used to fund an increase in salary.

Time off in lieu (TOIL) arrangements

This option does not directly increase the available capacity for service delivery and so its effectiveness may be limited during periods of prolonged workforce pressures. However, in certain circumstances, this option may help employers redistribute capacity over the year to ease pressures on service during busy periods.

Employers may offer staff TOIL instead of pay to reduce pensionable income and therefore pension growth. Reducing overall income could particularly help staff who are potentially affected by the annual allowance taper.