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How the 2025 Autumn Budget could Reshape Salary Sacrifice and Pension Tax Relief

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It's no secret that the Labour government currently faces a difficult economic backdrop. UK economic growth is showing signs of slowing (contracting by 0.3% in April) while government debt continues to rise.

When interest rates are high and GDP is weak, the Treasury's fiscal headroom is naturally eroded as tax receipts fall and the cost to service government debt increases. If these economic conditions continue, Chancellor Rachel Reeves would be forced to cut spending or increase taxes to fund day-to-day government spending.

With the recent U-turn on welfare cuts, it is becoming increasingly likely that taxes will be increased at the next Autumn Budget. However, raising taxes is not going to be an easy task, as the nation's tax burden is already at a record high.

Income Tax thresholds have been frozen since March 2021, whilst wages have risen significantly due to post lockdown inflation. As a result, many taxpayers find themselves in higher tax brackets due to wage inflation alone.

Additionally, Labour's manifesto pledged not to increase taxes on working people. This means that Income Tax, employees' National Insurance Contributions and VAT should be out of the question later this year.

Assuming Labour keep to their word (which, naturally, cannot be guaranteed), Reeves will need to look at other areas of the tax system to raise revenue.

At last year's Budget, the burden was placed on businesses in the form of increased employer National Insurance Contributions – reported to raise approximately £25 billion per year.

Raising business taxes further could prove risky and politically difficult, especially given the UK's deteriorating economic conditions.

This leaves pensions as one of the few areas still vulnerable to tax changes.

Last Autumn the Chancellor's Budget focused on bringing unused defined contribution (DC) pension funds into the estate for inheritance tax.

The 2025 Autumn Budget is nearing (the exact date has not yet been confirmed) and again, speculation about changes to the pensions regime is beginning to build.

According to the latest estimates, pensions Income Tax and National Insurance Contributions relief costs the UK government approximately £48bn per year. Accordingly, there is speculation that limits to tax relief on pension contributions could be introduced in the upcoming Budget.

Reeves will need to move carefully, especially given that she wants to use pensions as an engine for economic growth.

There are two features of pensions that are particularly prone to legislative tax changes – salary sacrifice, and higher rates of tax relief on contributions (as has been the case for more Budgets that we can remember).

Salary sacrifice

Commissioned under the previous government, HMRC published a report in May 2025 exploring the outcome of a proposed change to salary sacrifice – fuelling speculation that the rules could be amended in the Autumn Budget.

Under current rules, employees can forego some of their salary in exchange for a pension contribution. Salary sacrifice is extremely tax efficient because it means that employees pay less tax, and both employees and employers pay less NI contributions.

The study, conducted in 2023, proposed three hypothetical scenarios for employers to consider:

- Remove NI exemption for both employers and employees,
- Remove NI exemptions and employee Income Tax exemptions,
- Cap NI exemption to the first £2,000 of sacrificed salary.

Whilst all three options were viewed negatively by employers, they were most accepting of the third scenario, whereby employers and employees would have to pay NI contributions on any sacrificed salary above £2,000 per annum.

Although deemed as the most favourable scenario, employers cited concerns over the complexity and increased burden of calculating the amount of salary sacrificed per employee.

Other employers in the survey flagged that employee morale could be affected because of the additional charges to NI not previously incurred – and quite how Labour would square this with their promise not to raise employee NICs is another matter.

Tax relief on pension contributions

As mentioned, pensions Income Tax and NIC relief costs the UK government approximately £48bn per year. Of this figure, around £14.5bn relates to higher- and additional-rate tax relief.

Considering the above, another key area of speculation for the upcoming Autumn Budget is the introduction of a flat rate of Income Tax relief on pension contributions.

Currently, pension contributions benefit from tax relief at an individual's marginal rate. This means that basic rate taxpayers benefit from 20% tax relief, higher rate taxpayers 40% and additional rate taxpayers benefit from 45%.

Introducing a flat rate of pensions tax relief of say 20% or 25% would be expected to save the government several billion pounds each year and wouldn't negatively impact those on an average salary.

In practice, however, this would be extremely difficult to implement for those in net pay arrangements, where pension contributions are taken from pre-tax pay. To be effective, it is thought that HMRC would need to introduce a separate tax charge for such individuals.

This would negatively affect those in defined benefit schemes earning more than £50,270 per annum and could potentially risk Labour's relationship with high-earning NHS staff, teachers and other civil servants.

A much more simple approach would be to reduce the annual allowance, which is the maximum amount an individual can save into a pension in a single tax year. Since 6th April 2023, the annual allowance has been £60,000. Prior to this (and since 6th April 2014), the annual allowance was £40,000.

Reducing the annual allowance would be much easier to implement and it is thought that reducing the annual allowance back to £40,000 per annum would raise between £1-2 billion annually.

However, any reduction in tax relief will reduce the incentive to save into pensions and will potentially undermine the government's efforts to use pensions as an engine for domestic economic growth.

Conclusion

Whilst speculative, there is always the possibility that pensions tax legislation will be changed in some form in the next Autumn Budget.

For some higher- and additional-rate taxpayers, and after having taken appropriate advice, it may be wise to advance planned pension contributions or salary/bonus sacrifice before the Budget.

For others, it is important to remember that pensions are long-term savings vehicles and should be treated as such.

Nevertheless, ongoing reviews of pensions and their suitability will remain key during this changing legislative environment.

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