

HR BUDGET BRIEFING: THE “SMORGASBORD” BUDGET

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Today's much-awaited UK Budget did not contain the increases to the rates of income tax, National Insurance Contributions (NICs) or capital gains tax widely trailed in the press over the last few weeks. That said, employees (and their employers) are still likely to pay greater amounts in tax in the future as a result of the income tax and NICs thresholds being frozen (for a further three years) until April 2031. The Budget also contained a “smorgasbord” of other tax measures that will affect the way in which companies will remunerate their employees in the future, which we discuss in more detail below.

INCOME TAX AND NICs

While the rates of income tax and NICs applicable to employment income did not rise, the thresholds at which income tax and NICs become payable have now been frozen at their current levels since April 2022. Today's announcement [extends the freeze](#) on those thresholds for a further three years until April 2031. It allows the Chancellor to keep the Government's manifesto pledge not to raise income tax rates on “working people” (a pledge which briefly looked under threat in the run-up to the Budget). This freeze in the thresholds however stands to be one of the biggest revenue raising measures in the Budget. The Government expects it to raise over £10 billion by the end of the decade. For employers, the move may incentivise wage suppression and more tax-efficient incentives and benefits in lieu of salary increases.

The Chancellor announced that dividend income tax rates will increase by two percentage points with effect from April 2026. We anticipate that this increase will encourage more employees to hold (to the extent possible) any shares they own in their employer through tax-efficient Individual Savings Accounts (ISAs) to protect any dividends from income tax. Also, we expect that more companies operating an all-employee Share Incentive Plan (SIP) will apply an automatic reinvestment of any dividends payable on employees' SIP shares into additional “dividend shares” to be held within the SIP so as not to inadvertently expose employees to this additional level of tax.

The maximum value that individuals can contribute to an ISA overall has been maintained at £20,000, but the amount of annual cash investments an individual under 65 can make will be reduced to £12,000 from April 2027. From a share plan perspective, this is likely to increase the number of employees electing to transfer shares that they acquire under all-employee Sharesave options into an ISA within 90 days of exercise. This will use up any headroom they have under their ISA limit (for example, in circumstances where cash contributions cannot be made) and will protect the shares from capital gains tax whilst the shares are held in the ISA.

SALARY SACRIFICE

As anticipated, the Government is introducing changes to the way that salary sacrifice works in relation to pension contributions from 6 April 2029.

Under the current regime, it is estimated around one-third of employees contribute to their employer's pension arrangement via salary sacrifice arrangements. These arrangements effectively mean that employees agree to receive a lower salary in return for their employer

making increased pension contributions. As a result, both the employer and the employee pay NICs on a lower salary amount.

For employers, the NICs savings can be significant, as the employer rate is 15% of gross salary, with no upper limit. For employees, the savings are rather lower and are dependent on earnings - for earnings between £12,576 and £50,268 the rate is 8%, but drops to 2% on earnings above that.

The NICs savings made using salary sacrifice arrangements are often shared between the employer and employee and can result in either higher pension contributions, or more take-home pay for the employee.

Guidance says that, from April 2029, there will be a limit of £2,000 on the amount of any salary sacrifice for pension contributions that will be exempt from NICs. If an employee sacrifices more than £2,000 of salary for pension contributions (which will be reported to HMRC through payroll software), both employer and employee NICs will be due on the excess. This limit only applies in relation to salary sacrifice for pension contributions, and will not affect the current tax and NICs treatment where salary sacrifice is used for tax-free childcare. It will also not change the effect of any salary sacrifice arrangement as regards the application of the High Income Child Benefit Charge.

This will potentially have a significant impact for employers who currently offer salary sacrifice arrangements for pension contributions as the cost of continuing to provide these existing arrangements is likely to be increased.

PENSION SURPLUS

The Pension Schemes Bill contains provisions which will facilitate surplus funds being paid out of ongoing defined benefit (DB) schemes. The Government had also sought views as to how the tax regime “*could better support surplus sharing*”. The **responses** suggested that amendments could be made which would allow surpluses to be paid to members as lump sums - which would have the advantage of cost certainty, as opposed to an augmentation of pension. Such a one-off payment would not currently be an authorised payment under the Finance Act 2004 regime.

The Budget says that the Government intends to “*enable well-funded DB pension schemes to pay surplus funds directly to scheme members over the normal minimum pension age, where scheme rules and trustees permit it, from April 2027*”. It is not entirely clear what is being proposed here, but it could relate to allowing one-off lump sum payments.

INHERITANCE TAX

In the 2024 Budget, the Government announced that it would impose inheritance tax on unused pension funds and death benefits (although not death in service benefits) from 6 April 2027.

In the intervening year, there has been ongoing consultation with industry on the practicalities of implementing these proposals and the Chancellor has announced further practical changes to the operation of the new regime.

In particular, it is now proposed that a deceased member’s personal representatives will be able to direct scheme administrators to withhold payment of up to 50% of any taxable benefits on death for up to 15 months, and to pay any inheritance tax due on those benefits. These new provisions will need to be factored into administration processes on death, and the full implications of these changes will need to be considered well in advance of the April 2027 implementation date.

PPF AND FAS COMPENSATION

Under existing legislation, where members receive compensation from the Pension Protection Fund (PPF) or Financial Assistance Scheme (FAS), no increases are paid in respect of pre-April 1997 service. For members with significant amounts of pre-1997 accrual, this means that, over time, the real value of any compensation they are entitled to receive from the PPF or FAS can be significantly eroded.

As a result, the Government is proposing to introduce “*CPI-linked increases, capped at 2.5% a year, on [compensation in respect of] pre-1997 pension accruals where their original schemes provided this benefit, from January 2027*”.

Again, there is currently no detail about these proposals, and it is not clear if they will have any knock-on effects in other areas. For example, the statutory order of priority for distributing assets on winding-up is linked to PPF benefits, and

adding an element of pre-1997 increases into PPF compensation will put these benefits higher up the priority order where a scheme is winding-up when in deficit.

EMPLOYEE SHARE PLANS

The Government also proposes (in the next Finance Act with effect from 6 April 2026) to extend the types of companies which can grant HMRC-approved Enterprise Management Incentive (EMI) options. Using these tax-efficient options, employees are taxed at an effective rate of 18% on any growth in the value of the shares subject to the option from the time at which the options are granted (compared to an effective rate of 47% on a “normal”/“tax-unapproved” option or award). Under these proposals, a company (or corporate group) may have up to 500 full-time equivalent employees (up from 250) and gross assets of up to £120 million (up from £30 million) and still grant these highly favourable EMI options. The maximum value of shares over which EMI options can be granted (measured at the time the EMI options are granted) is also due to rise from £3 million to £6 million. Finally, the maximum “life” of an option, during which period the option can be exercised and benefit from the favourable EMI tax regime, will also rise from 10 to 15 years, which will apply to options already granted as well as future awards.

SDRT EXEMPTION FOR NEW LISTINGS

To encourage more companies to list on UK-regulated markets, such as the Main Market of the London Stock Exchange, shares traded on that market will be exempt from the usual 0.5% Stamp Duty Reserve Tax charge for three years from when the company lists on that market. This temporary exemption will apply with effect from 27 November 2025 (i.e. tomorrow).

INCREASES TO NATIONAL LIVING AND MINIMUM WAGE

Announced a day ahead of the Budget, the Government is accepting the recommendations of the Low Pay Commission for the annual increases to the National Living Wage (NLW) and National Minimum Wage (NMW). From April 2026:

- the NLW will increase by 4.1% to £12.71/hour;
- the NMW for workers aged 18-20 will increase by 8.5% to £10.85/hour;
- the NMW for workers aged 16-17 and apprentices will increase by 6% to £8.00/hour; and
- the accommodation offset will increase by 4.1% to £11.10 per day.

These are more modest increases than those imposed in April this year. The higher increase for the NMW 18-20 rate is to equalise it with the NLW over time, in line with the Government’s manifesto commitment to abolish age banding for minimum pay rates for over 18s.

The increase means higher costs for employers and may disproportionately impact graduate jobs. The new NLW rate will be close to many existing entry-level graduate salaries and could require some businesses to increase those salaries to remain competitive. On the other hand, the move may compound broader concerns in the economy around hiring, particularly when coupled with measures in the Employment Rights Bill (ERB) to extend “day 1” rights to unfair dismissal protections.

Employers also need to bear in mind the forthcoming changes to the enforcement of NLW/NMW compliance via the new Fair Work Agency (FWA) from April 2026. The Budget promises a number of new enforcement measures, including the FWA working closely with trade unions and local business groups, following up directly with employers on worker complaints, and more regular “naming and shaming” rounds. The Government will also explore how the FWA can use powers in the Companies Directors Disqualification Act 1986 to disqualify directors whose abuse of workers’ rights makes them unfit to be concerned in the management of a company, particularly where there are repeated breaches.

OTHER EMPLOYMENT MEASURES PUBLISHED ALONGSIDE THE BUDGET

Non-compete reform

As the Budget was being delivered, the Department for Business and Trade launched a new [Working paper on options for reform of non-compete clauses in employment contracts - GOV.UK](#). The paper, which to a large extent revisits previous proposals to reform non-compete clauses, seeks views on a number of potential measures, including:

- introducing statutory limits on the length of non-compete clauses;
- banning non-compete clauses in employment contracts;
- banning non-compete clauses below a salary threshold; and
- combining a ban below a salary threshold with a statutory limit.

The proposals are stated to be part of the Government's commitment to a dynamic labour market that enables people across the country to seize the opportunities of employment and drives economic growth. Comments are invited on the proposals by 18 February 2026, which may inform more concrete proposals at a later date.

PAYE reform for umbrella companies

Also published today was a previously announced measure - [Umbrella company market – changes to Income Tax rules to tackle non-compliance - GOV.UK](#) - to tackle non-compliance in labour supply chains which include an umbrella company, or any third party supplying labour. The measure introduces legislation to make recruitment agencies or end clients accountable for Pay as You Earn (PAYE) liabilities on payments to workers supplied through umbrella companies. It will have effect from 6 April 2026.

Payments for shift changes

A new Tax Information and Impact Note [Income Tax: cancelled, moved or curtailed shifts - GOV.UK](#) confirms that payments received by workers for cancelled, moved or curtailed shifts are earnings and therefore subject to income tax. These payments are due to be introduced under the ERB. The measure will have effect from the first day on which the ERB brings into effect the statutory duty to make the payments (not currently anticipated to be earlier than 2027). The Government will also introduce secondary legislation to confirm the NICs treatment for these payments.

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