

Salary sacrifice



What is salary sacrifice?

One way to save and invest for your retirement is by making salary sacrifice (concessional contributions) to your superannuation. This strategy may allow investors to reduce their taxable income and build their retirement savings at the same time. Some may see it as a way to *have their cake and eat it too*.

Salary sacrifice is an agreement between you and your employer to contribute some of your salary or bonus directly into your superannuation before tax is deducted at your marginal tax rate (which could be up to 46.5 per cent). For a salary sacrifice arrangement to be valid under tax law, it must be 'prospective' in nature. That means you can only arrange to sacrifice income or a bonus payment before you have earned it. Not all employees have salary sacrifice agreements in place. You may wish to discuss these arrangements with your employer.

Advantages of salary sacrifice

This method of contributing to your super may be tax effective as the contributions are taxed at 15 per cent which is lower than the highest rate of marginal tax of 46.5 per cent (including the Medicare levy). Furthermore, whereas earnings within superannuation are taxed at 15 per cent, earnings from non-superannuation investments are often taxed at your marginal tax rate. This is often higher than 15 per cent as the table below illustrates.

Taxable income	Marginal tax rate
\$0 – \$6,000	Nil
\$6001 – \$35,000	16.5 per cent
\$35,001 – \$80,000	31.5 per cent
\$80,001 – \$180,000	39.5 per cent
\$180,001 and over	46.5 per cent

Funding your superannuation via a salary sacrifice arrangement has some advantages that may make it more attractive than other forms of investment.

The contribution rules

Super contributions made from before-tax income for which a deduction can be claimed by the contributor are also known as concessional contributions. The Federal Government has imposed a concessional contributions cap, which limits the amount of superannuation contributions that can be made on your behalf before you incur tax penalties.

The table below summarises the tax payable on concessional contributions for 2009-2010 financial year.

Situation	Concessional contributions
Standard contribution	15% tax
If no TFN quoted	15% plus 31.5% tax on all contributions – deducted at 30 June each year or on leaving the Fund.
Contributions that exceed the concessional contribution (CC) caps: <ul style="list-style-type: none"> • \$25,000 if aged less than 50; • \$50,000 if aged 50 or over (to 2011-2012). 	15% plus 31.5% tax imposed by the ATO and excess contributions count towards your non-concessional contribution (NCC) cap.

A limit of \$25,000 per person applies for the 2009-2010 financial year (in future years this cap will be indexed in line with Average Weekly Ordinary Time Earnings (AWOTE) in increments of \$5,000). As a transitional arrangement, people who are aged 50 and above from 1 July 2007 will have a limit of \$100,000 each year until 30 June 2009. From 30 June 2009 the transitional limit has been reduced to \$50,000 each year until 30 June 2012. Additional tax of 31.5 per cent can be incurred for contributions exceeding the concessional contribution limit. Any excess amount over your concessional contribution limit will be counted towards your non-concessional contribution limit.

Overall tax position

When considering a salary sacrifice arrangement, you should consider your overall tax position, as super is taxed at various stages including when the benefit is paid if you are aged less than 60.

Salary sacrifice – how does it work?

Ronald is aged 45. He receives a salary of \$80,000 a year and is expecting a bonus of \$5,000. His employer pays the minimum rate of employer contribution under law.

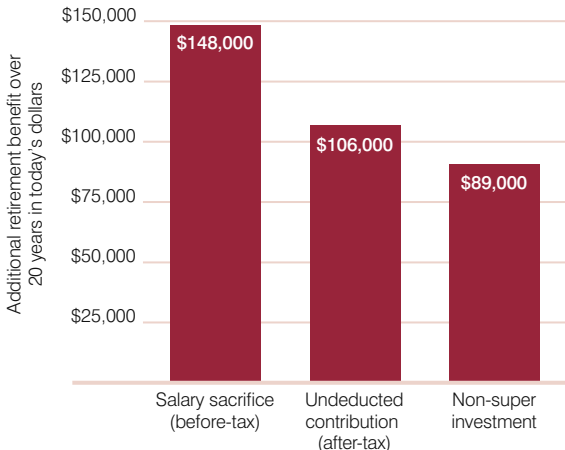
On the advice of his financial adviser, Ronald negotiates with his employer to have his bonus paid directly into his super fund, rather than receiving the money as cash salary. The arrangement – which is documented and signed by both parties before the bonus is paid – will enable Ronald to invest an additional \$1,225 into his superannuation, as shown in the following table:

	Bonus as after-tax salary	Bonus as salary sacrifice
Before-tax bonus	\$5,000	\$5,000
Less income tax at 39.5%*	(\$1,975)	n.a.
Less contributions tax at 15%	n.a.	(\$750)
Net amount to invest	\$3,025	\$4,250
Additional amount to invest		\$1,225

* Includes a Medicare levy of 1.5%.
The rates of tax and thresholds are for the 2009-2010 tax year and are subject to change.

Assuming Ronald retires in 20 years time, the graph below compares the value of his investment after tax is taken into account (see assumptions below). As you can see, salary sacrificing his bonus of \$5,000 each year has provided Ronald with a better outcome than investing his bonus after-tax within or outside super.

The long-term benefits of salary sacrifice: \$5,000 invested over 20 years



Assumptions:

Bonus of \$5,000 before-tax or equivalent \$3,025 after tax is contributed at the end of each year until retirement age 65. Contributions not indexed. Moderate investment portfolio for super and non super money. Return for super 8.0% p.a. after fees and taxes, return for non-super 8.5% p.a. after fees, tax paid by investor not in the fund. Inflation 3.0% p.a. Salary growth 4.0% p.a. No administration fees. Contributions tax 15% p.a. Franked income in the moderate portfolio: 23.6%. Income return: 3.6% and capital gain return: 4.9% Non super investment pays a distribution at the end of the year based on 3.6% income return, taxed at marginal rates and net amount re-invested at year end. At age 65, the non-super investment is redeemed and CGT is paid using the 50% rule. No lump tax on super at age 65. No Superannuation Guarantee contributions allowed for. Max co-contribution rate of \$1.00 per \$1.00 until 2011-12, \$1.25 per \$1.00 from 2012-13 to 2013-14 and \$1.50 per \$1.00 from 2014-15 onwards paid at the end of the year. Projections based on marginal tax rates and low income tax rebates announced in 2009 Federal budget including Medicare Levy. 2010-11 rates are assumed to continue thereafter. Medicare Levy Surcharge is not paid. Investment performance can go up and down and the assumptions used may vary. Figures are rounded to nearest \$1,000.

Where to from here?



Thinking about your next steps you may want to consider:

If your employer will allow you to salary sacrifice

Contact your Payroll/Human Resources/Personnel Department (as applicable) if you wish to implement a retirement savings plan through salary sacrifice.

Whether to make a before or after-tax contribution

Whether you decide to make a contribution from before or after-tax income will depend on your circumstances and your income.

To find out more or learn about other available options, please contact Plum by email – service@plum.com.au or call a Plum Member Services Consultant between 8.00am and 6.00pm, Australian Eastern Standard Time any business day on **1300 55 7586** or take a look at the learning resources, tools and calculators available on the Plum website – www.plum.com.au



Did you know...

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If you would like more information about *Momentum Financial Advice* or would like to access this service, contact a Plum Member Services Consultant on **1300 55 7586**.

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Speak with a Plum Member Services Consultant on **1300 55 7586**.

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