

Educational Series

Boost your retirement funds – salary sacrifice



An effective 'salary sacrifice' strategy now could be the key to getting more from your super in the future.

What is salary sacrifice?

Salary - a fixed regular payment made by an employer to an employee

Sacrifice - an act of giving up something that one values for the sake of something that is of greater importance



Putting together these two dictionary definitions may help clarify what 'salary sacrifice' is – giving up salary (something of value) for the sake of something important (in this case, super contributions and your future retirement income). What the dictionary doesn't tell us is how this works in practice and why salary sacrificing to super may be beneficial depending on your personal circumstances.

Most employees receive employer super guarantee contributions of at least 9% of their salary. Many also top-up their super using available money at the end of the financial year. A third option, which can be an easy, tax-effective way of topping up your super, is to salary sacrifice to super. This simply involves agreeing with your employer for some of your pre-tax salary to be paid directly to your super fund, before income tax is deducted. The sacrifice comes from not having that amount paid to you as in-your-pocket salary. There are three very important reasons why salary sacrifice can be an effective way to save for retirement.

1 Tax effective

You don't pay income tax on amounts you salary sacrifice to super. Instead your super contributions are usually taxed at 15%,¹ which can be much less than your marginal tax rate. In addition, you may pay a lower rate of income tax if your salary sacrifice means your remaining salary then falls into a lower income tax bracket.

Let's say you earn \$85,000 a year. Your marginal tax rate² is 39.5% and your total tax bill is \$21,025. If you salary sacrifice \$5,000 to super, your salary is now \$80,000, your income tax has reduced to \$19,050 and your marginal tax rate is 31.5%. The \$5,000 is contributed straight to your super fund, where it is taxed at just 15%. So overall you've gone from paying \$21,025 in tax to \$19,800, a saving of \$1,225.

¹ If the total of your salary sacrifice, Superannuation Guarantee and other employer or personal deductible contributions exceeds your concessional contributions cap, you may be liable for additional tax of 31.5% on the excess contribution. For 2009–10 the concessional contributions cap is \$25,000 for those under age 50 in the financial year and is \$50,000 for those aged 50 or more in the financial year. You may also be liable for more tax if you do not provide your Tax File Number to your super fund provider.

² Based on 2009/10 personal income tax rates, including medicare levy.

2 Grow savings more quickly

As well as helping your savings grow by having more to invest, salary sacrificing to super can mean higher investment returns, once you take tax into account. This is because the maximum tax on investment earnings from super is 15%. The same investment earnings outside super are taxed at your marginal tax rate, up to 46.5% (including Medicare levy).

On the assumptions stated after 20 years of salary sacrificing \$5,000 each year, beginning with nothing, your super could grow to \$98,000. Taking your \$5,000 as salary each year and then investing it outside super could result in accumulated savings of \$57,000. This assumes: both investments earn a return of 7% pa after fees and before tax; returns are 3% pa growth and 4% pa income, 30% franked; results take into account the effects of inflation at 3% pa.

This example is for illustration purposes only and does not represent actual returns. A change to one or more of the variables and assumptions will produce different results. Your individual circumstances have not been taken into consideration.

We've seen how the end result of a tax-effective salary sacrifice strategy can mean more retirement savings. This strategy combined with the benefits of compounding your returns in superannuation can mean higher retirement savings, and more flexibility with your retirement plans – for example, an earlier retirement or a higher or longer-lasting retirement income. So, even a small salary sacrifice each year while you're working can have a very important outcome when it comes time to retire. We recommend you speak to your financial adviser to see if this strategy may suit you.

* Please note that superannuation is a long term investment. By salary sacrificing into super you will not be able to access it until you retire.

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