GARVAN FINANCIAL PLANNING

Guide to…

Salary Sacrifice

What is salary sacrifice?

Salary sacrifice is an arrangement between you and your employer, which involves giving up part of your pre-tax salary in exchange for an alternative benefit, such as superannuation contributions.

Arranging a salary sacrifice agreement can not only be beneficial to you, it can also be beneficial to your employer as your salary package costs less for them to provide. However, salary sacrifice into superannuation needs to be looked at carefully, as there are some important issues to consider.

How does it work?

If you want to contribute $1,000 of your salary to superannuation, there are two ways in which you can achieve this. You can invest your income after tax, (this is known as making an undeducted contribution) or you can enter into a salary sacrifice arrangement with your employer.

The after tax value of your $1,000 is $515, assuming that tax is payable at the highest marginal tax rate of 47% plus Medicare levy. This means that you will have only slightly more than half of your initial $1,000 to invest.

When you arrange to salary sacrifice, your employer contributes to superannuation on your behalf. The amount of the contribution is deducted from your gross (before tax) salary. In this way, your superannuation is funded by pre-tax dollars. You only pay personal income tax on the balance of your salary.

Out of the $1,000 contributed to the superannuation fund by your employer as a result of your salary sacrifice, the superannuation fund will deduct tax from the contribution at the rate of 15%. Effectively, a sum of $850 will usually be available for investment by the trustee of the superannuation fund on your behalf.

High income earners are also subject to the superannuation contributions surcharge and pay up to an additional 12.5% tax on employer contributions (from 1 July 2005 the tax rate will be 10%). The surcharge begins to apply once your "adjusted taxable income" reaches $99,710 and becomes 12.5% once your "adjusted taxable income" exceeds $121,075 (these thresholds are for the 2004/05 financial year and are indexed annually). "Adjusted taxable income" is taxable income plus the grossed up value of employment fringe benefits plus (in this context) employer superannuation contributions. These items are added onto taxable income as otherwise people would have a tendency to salary package to avoid the surcharge.

Even if the full 12.5% surcharge applied in addition to the 15% contributions tax, this still means that $725 is invested in the superannuation fund out of an initial $1,000. This still remains superior to the alternative of receiving $515 after personal income tax.

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Some issues to consider

A number of issues should be considered before entering into any arrangement:

- Contributions that are made to superannuation through salary sacrifice or undeducted contributions made after 1 July 1999 are subject to the Government's preservation rules. This means that any contributions made must generally be kept in the superannuation fund or rolled over to an approved fund until you retire at or after age 55. Contributing additional funds to superannuation is not a viable solution if you wish or have a need to withdraw the funds prior to retirement.
- The government has set limits on the amount of concessionally taxed superannuation benefits that you can receive in your lifetime. These are known as your Reasonable Benefit Limits (RBLs). If you wish to arrange a salary sacrifice, it is important to take into account your superannuation entitlements and your RBL position.
- Superannuation benefits in excess of your RBL that you receive as a lump sum are taxed at the highest marginal tax rate (currently 48.5%, including the Medicare levy).
- Employers who make superannuation contributions on your behalf are eligible to claim a tax deduction for the contributions made. There are limits to the amounts that can be claimed which are based on age. Before entering a salary sacrifice arrangement, it is important to know your contribution limit.

For 2004/05 the contribution limits are:

Age	Contribution
Under 35	$13,934
35 to 49	$38,702
50 and over	$95,980

- Before arranging a salary sacrifice arrangement, you should check that this will not affect other entitlements that you have with your employer, such as workers compensation.
- When the superannuation benefits are withdrawn at a later stage upon satisfaction of a condition of release, tax is payable by you on the eligible termination payment if it is taken in the form of a lump sum. You can discuss strategies for withdrawing eligible termination payments with your financial planner.
- Salary packaging may not be appropriate for those in low income tax brackets.

Effective salary sacrifice

Salary sacrifice is only effective if the following conditions have been satisfied.

- As an employee you must elect to enter into the salary sacrifice arrangements prior to the point in time at which any relevant employment services are performed, or prior to the commencement of services. In other words, salary sacrifice must not be retrospective. Salary sacrifice arrangements must be made in writing between you and your employer.
- Your cash salary must not be reduced below the minimum level specified in any relevant award or industrial agreement.
- The salary packaging agreement must not allow cash to be received instead of non-cash benefits.

Salary sacrifice can serve remuneration planning and savings objectives. However, the rules are complex and it is important that you get appropriate advice before you enter into any arrangement.

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