Colonial First State

Boost your retirement funds – salary sacrifice

Educational series

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 may be of greater importance.

Putting together these two 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 9.25% of their salary paid since 1 July 2013. This percentage is set to increase to 12% by 2019. Many employees also top-up their super by making personal after-tax contributions from 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 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 two 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, if you are a higher income earner you may pay a lower rate of income tax if you salary sacrifice and your remaining salary may fall into a lower income tax bracket.

Let's say you earn $85,000 a year. Your marginal tax rate[2] is 38.5% and your total tax bill is $20,672. If you salary sacrifice $5,000 to super, your salary is now $80,000, your income tax has reduced to $18,747 and your marginal tax rate is 34%.

The $5,000 is contributed straight to your super fund, where it is taxed at just 15%. So overall you've gone from paying $20,672 in tax to $19,497, a saving of $1,175.

1 From 1 July 2013, if the total of your salary sacrifice, superannuation guarantee and other employer or personal deductible contributions exceeds your concessional contributions cap, you will effectively be taxed on your excess concessional contributions at your marginal tax rate as the excess concessional contributions will be included in your assessable income with a 15% tax offset allowed. An interest charge may also apply. You may also elect to release up to 85% of the excess contributions from your super fund to manage your non-concessional contribution cap. Excess concessional contributions released to the ATO will be treated as a tax credit. Between 1/7/2007 and 30/6/2013, excess concessional contributions would generally incur additional tax of 31.5% on the excess contribution.

2 Based on 2013–14 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).

After 20 years of salary sacrificing $5,000 each year, beginning with nothing, your super could grow by almost $98,000. Taking your $5,000 as salary each year and then investing it outside super could result in accumulated savings of $58,000.

This assumes: both investments earn a return of 7.7% pa after fees and before tax. Results take into account the effects of inflation at 3% pa. Outside super the investor is taxed on investment earnings at the marginal tax rate of 38.5%. Super earnings are taxed at 15%. All figures are in today's dollars.

This example is for illustrative purposes only and does not represent actual returns.

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 suits you.

Note: Please note that superannuation is a long term investment. By salary sacrificing into super you will not be able to access it until you satisfy a condition of release such as reaching preservation age or retiring.

Need more information?

Please speak with your financial adviser or visit our website at colonialfirststate.com.au

Alternatively, you can contact us: Enquiries about existing investments, please call 13 13 36.
Enquiries about new investments, please call 1300 360 645.

19455/FS1859/0713