When is it worth your while to salary sacrifice into super?

Your questions answered

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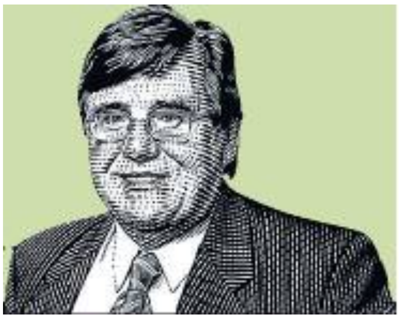

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Q I have a question about salary sacrifice into super. A few years ago when my annual income was about $60,000, I looked at a few online calculators and decided I didn't gain much additional super from this. My income has risen to $110,000 and I'm wondering if it is now worth it? How can I tell? I have an employer who contributes 10 per cent to my super. – Zac.

A: Salary sacrifice is a savings strategy where you choose not to spend all your employment earnings and instead contribute as much you can afford as extra tax-concessional contributions – over and above the 10 per cent employer contributions you receive. Whether it is worthwhile to salary sacrifice comes down to what your objectives are, says Tim Miller, education manager with self-managed super administrator SuperGuardian.

Any decisions about entering into a salary sacrifice arrangement are best determined by your level of disposable income and whether you are trying to maintain that level of income while trying to increase your super. It will also be influenced by whether you are happy to reduce your disposable income and focus exclusively on super.

Other key factors are your age and when you expect to retire.

As a guide to these influences, as someone earning $110,000 where an employer is contributing 10 per cent on top of that, you will be receiving $11,000 of tax-concessional employer contributions which will attract a tax liability of 15 per cent (or $1650) payable from your super fund and resulting in a net contribution of $9350.

With the tax-concessional contribution cap at $27,500, this means you could contribute a further $16,500 via a salary-sacrifice arrangement which would attract a tax liability of $2475 when this is contributed to super.

A super contribution is classified as tax concessional because your employer can claim this as a business expense while the contribution will be taxed at a reduced rate of 15 per cent by your super fund instead of the 34.5 per cent it would have been liable for had it been paid to you as extra salary.

Your net additional contribution to super from salary sacrifice would be $14,025, lifting your total contributions to $23,375. Looked at another way, this will see your total net super contributions increase from about $180 a week from employer support to about $450 a week by adding $270 in salary-sacrifice contributions.

In terms of the impact on your disposable income, while deducting $16,500 from your $110,000 gross income will reduce this to $93,500, more important is the after tax effect.

After marginal tax of 34.5 per cent (including 2 per cent Medicare), your disposable income will reduce from about $82,100 to around $71,750 after the additional super is contributed – a $10,350 reduction in disposable income (or about $200 a week, from $1580 a week to about $1380).

Miller says what needs to be factored in is what you currently do with your disposable income. If you invest it, the earnings will be taxed at your marginal rate of 34.5 per cent. Where the savings are invested in super, however, they will generate a greater return because income will be taxed at 15 per cent.

This highlights that the difference between your personal or marginal tax rate and the 15 per cent tax rate on super contributions is the main benefit of making extra tax-concessional contributions.

How worthwhile salary sacrifice is can also be assessed by calculating the long-term effect it will have on the super you accumulate.

Super calculators such as those found on the Australian Securities and Investments Commission's moneysmart website can be helpful. As well as providing simple solutions to such questions as how much salary you could contribute under the contribution rules and how such contributions will be taxed, there are also calculators that can work out your super balance at retirement based on your significant ages (when you start contributing and when you expect to retire), your salary, the 10 per cent employer contribution and any additional contributions you make.

For instance, if you were earning income from about 30 of $60,000, which increased to $110,000 at 35 and the only contributions made were the 10 per cent employer amounts, you could accumulate a balance of just over $400,000 by 67. What is significant about such an amount is that it would entitle a home-owning retiree couple to the full government age pension.

If you proceed with salary sacrifice, you must monitor this in case an employer is negligent in making the contributions. Every agreement should include a specific time when contributions must be made. While compulsory employer contributions must be made either every month or every quarter, there are no set rules when salary-sacrifice amounts must be paid into your super fund unless you set them and then monitor them.

If an employer experiences financial difficulties and does not make the agreed salary sacrifice contributions, the employee would have to chase up missed payments.[SI]