

Salary sacrifice and transitioning to retirement

With the growing demands of an ageing population, forever tightening welfare benefits, and greater concessions given to self-supporting retirees, the need to maximise your super to ensure a comfortable retirement has never been greater.

For these same reasons, the Federal Government offers numerous tax incentives for those who make extra super contributions and this means that super is now one of the most attractive ways to build your long-term savings.

Extra contributions to super can be made with before-tax or after-tax dollars, or a blend of the two. The way in which you make those contributions will determine whether you are eligible for any additional concessions or tax benefits.

There are a number of super savings opportunities available, however, in this fact sheet we focus on salary sacrifice and combining this strategy with a Transition to Retirement pension.

What is salary sacrifice?

Salary sacrifice is an arrangement with your employer*, where you agree to receive part of your gross salary as a benefit rather than as salary. The value of this benefit is paid from your gross salary i.e. before tax. This means that your gross salary is reduced by the cost of the benefit before tax is calculated.

Tax savings with salary sacrifice

The most popular form of salary sacrifice is contributing an amount into super from your gross salary and there are a number of tax benefits in doing this.

Firstly, sacrificing some of your salary into super reduces your taxable salary. As a result, you may pay less tax. Secondly, while no income tax is levied on the contribution amount sacrificed out of your salary, tax is levied on this amount when it enters the super fund. This tax rate is 15%, which may be lower than a person's marginal income tax rate.

NOTE: From 1 July 2009 the concept of "income" in determining entitlement to certain Government benefits that are income tested include 'salary sacrificed' contributions to superannuation.

Is salary sacrifice for you?

It is important to remember that salary sacrifice will reduce your 'take home' pay. However, depending on your level of income, salary sacrifice can be a very tax-effective way to contribute to your super.

Incentives for low and middle income earners and the availability of rebates in relation to 'spouse' contributions, though, mean that salary sacrifice may not always be the most tax efficient way to contribute to super.

Further, there is a limit on the amount of before-tax contributions (called concessional contributions) that can be made in each financial year.

*Please note that it is not compulsory for your employer to enable salary sacrifice but if it does, it may place restrictions on the amount you can salary sacrifice and/or the frequency that you can change your election.

Salary sacrifice and transitioning to retirement

It is also important that you check with your employer that they won't reduce your "salary" for Superannuation Guarantee (SG) contribution purposes, as a result of a salary sacrifice arrangement. It is common for employers to base their 9% SG obligation on the total remuneration package, but it is not always the case.

Super limits

In the past, the size of before-tax contributions you or your employer could make to your super was limited by your age. Now there are no age based limits. In fact, you are now allowed to make before-tax contributions to super until you turn 75 subject to you working at least 40 hours in a period of not more than 30 days for those aged between 65 and 75 (although the Superannuation Guarantee only applies up until age 70).

From 1 July 2009, any before-tax contributions you or your employer make up to \$25,000* a year will be taxed at 15%. Any amount over \$25,000 will be taxed at an additional 30% plus the Medicare levy.

If you are aged 50 or older or you turn 50 between 1 July 2009 and 30 June 2012, you may benefit from transitional arrangements which allow you to make before-tax contributions of up to \$50,000 (at the 15% tax rate) each financial year until 30 June 2012.

Transitioning to retirement

Changes announced by the Federal Government in recent years make it much easier for Australians to ease into retirement slowly from age 55 and offer them much more flexibility in how they do it.

Firstly, from 1 July 2005, the Government has allowed Australians who have reached their preservation age**, and depending on the rules of their super fund, to draw on their super without having to retire permanently from the workforce. In other words, enabling them to transition to retirement.

Under these rules, you have to use your super to buy a special 'income stream'. The special income stream is referred to as a Transition to Retirement (TTR) pension, which is a non-commutable income stream or account-based pension (the new name for an allocated pension). It lets you receive a regular income from your super benefits but your super can't be withdrawn as a lump sum until you meet a condition of release^W.

With this measure, you can roll some or all of your eligible super over into a TTR pension. You then reduce the hours you work and make up for this by drawing down some of this income stream. However, if you are still working, your employer will still be paying the 9% Superannuation Guarantee on your superable salary into your super, allowing you to continue to add to your super savings, even though you are drawing down some in the form of a retirement income stream.

In addition, recent Government reforms to super now make transitioning to retirement even more attractive than ever before.

They have removed tax on super benefits for anyone over 60. And, for those investing in an account-based pension, there's no tax on the earnings within the fund.

Further, from 1 July 2007, as part of the Government's reforms, those who take up a transition to retirement pension are able to receive a maximum of 10% of the account balance (at the start of each financial year) of their account-based pension as a pension payment in any one financial year.

*This amount is indexed to Average Weekly Ordinary Time Earnings (AWOTE) but will only increase in \$5,000 increments.

**Your preservation age is the age you are allowed to access your super benefits when you stop working and depends on your date of birth (it is 55 for those born before 1/7/60).

Salary sacrifice and transitioning to retirement

Combining a salary sacrifice strategy with a TTR pension

If you choose to work fewer hours, commencing a TTR pension can help to supplement your part-time income. Alternatively, you can maintain your current work hours while using smarter strategies to accumulate super.

Combining a TTR pension with a salary sacrificing strategy into superannuation may increase your overall tax savings because:

- Salary sacrifice contributions are taxed at 15% going into super. So for every dollar salary sacrificed into super 85c will be invested. Whereas if you elected to take this money in cash, for every dollar earned you pay tax at your marginal tax rate - up to 46.5%. This represents an after-tax saving of up to 31.5%.
- Super pensions pay no income tax (interest or dividends) or capital gains tax on investment earnings.
- If you're between the ages of 55 and 59, the 'taxable' portion of pension income paid out will attract a 15% tax rebate.
- For taxpayers aged 60 years plus, pension income paid out is tax free.

For example...

Let's take someone on a salary of \$100,000 per annum and a superannuation benefit worth \$250,000. All income is assumed to be spent. They then commence a TTR with the entire benefit and elect to take the maximum pension income of 10% or \$25,000 per annum.

Column 2 illustrates the results for someone in the 55 – 59 age bracket. To maintain the same level of net income (\$73,050), they should salary sacrifice \$31,198 per annum. This is a 'worst case' example in that it assumes the entire income stream is taxable, which won't always be the case. The outcome may therefore be even better in this situation.

Column 3 illustrates the results for someone age 60 or above. As the entire pension is tax free, it allows more salary sacrifice contributions to be made, resulting in a higher tax saving and ultimately, a greater accumulation of superannuation savings.

	Salary only	TTR & salary sacrifice	
		If 55 - 59	If 60+
Gross Salary	\$100,000	\$100,000	\$100,000
Plus TTR Pension Income	\$0	\$25,000	\$25,000
Less Tax-free Amount from TTR Pension	\$0	\$0	\$25,000
Less Salary Sacrifice Contributions	\$0	\$31,198	\$38,832
Total Taxable Income	\$100,000	\$93,802	\$61,168
Income Tax Payable (2009/10)	\$25,450	\$23,095	\$12,200
Medicare Levy	\$1,500	\$1,407	\$918
Less TTR Pension Rebate	\$0	\$3,750	\$0
Total Income Tax and Medicare Levy Payable	\$26,950	\$20,752	\$13,118
Plus Contributions Tax	\$0	\$4,680	\$5,825
Total Tax Payable	\$26,950	\$25,431	\$18,943
Net Income	\$73,050	\$73,050	\$73,050
Income Tax Savings		\$1,519	\$8,007
Additional Super Contributions (net of Pension Income)		\$1,519	\$8,007

Need further information?

What's best for you will depend on your particular circumstances. You should get specialist financial planning advice before making any decisions to salary sacrifice into super or take up a Transition to Retirement pension. Our team of financial planners can assist you so call today on **1300 369 901**.