

Educational Series

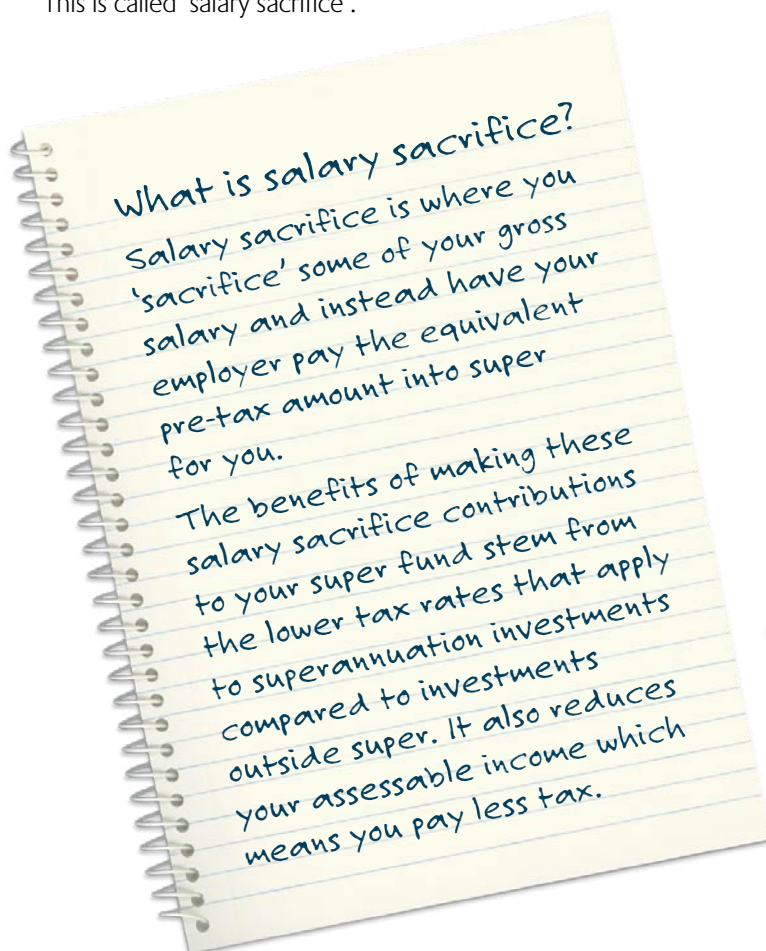
Boost your retirement funds – salary sacrifice



The tax benefits of sacrificing a small amount of your salary today can make a big difference to your retirement income tomorrow.

Many people tend to ignore their super and put off thinking about their retirement until it's just around the corner. We appreciate that we cannot rely on the Government to pay for our retirement and recognise a need to save. While we know that we need to do something about it, somehow it just never happens.

Currently, most employees are receiving superannuation contributions from their employer of at least 9% of their salary. Adding to these contributions directly from your gross or pre-tax salary can be an easy, tax effective way of topping up your super. This is called 'salary sacrifice'.



Why can salary sacrifice be an effective way to save for retirement?

1. It is tax effective

Income tax is only levied on income you actually receive so you do not pay income tax on salary sacrifice contributions to super. Your super contributions are taxed at 15%, representing a significant tax saving, particularly if you are on the highest marginal tax rate of 46.5%.

Also, by making a salary sacrifice contribution it is possible that your taxable income is reduced and you are brought down into a lower income tax bracket, further reducing your income tax bill.

2. More money is available for investment

This difference in taxation means that more money is available for investment than if you were to receive the money as after-tax income and then invest it.

3. You pay less tax on returns from your super investments

The maximum tax on investment earnings from your superannuation is 15%. This is often significantly better than the tax on returns outside super which can be as high as 46.5%.

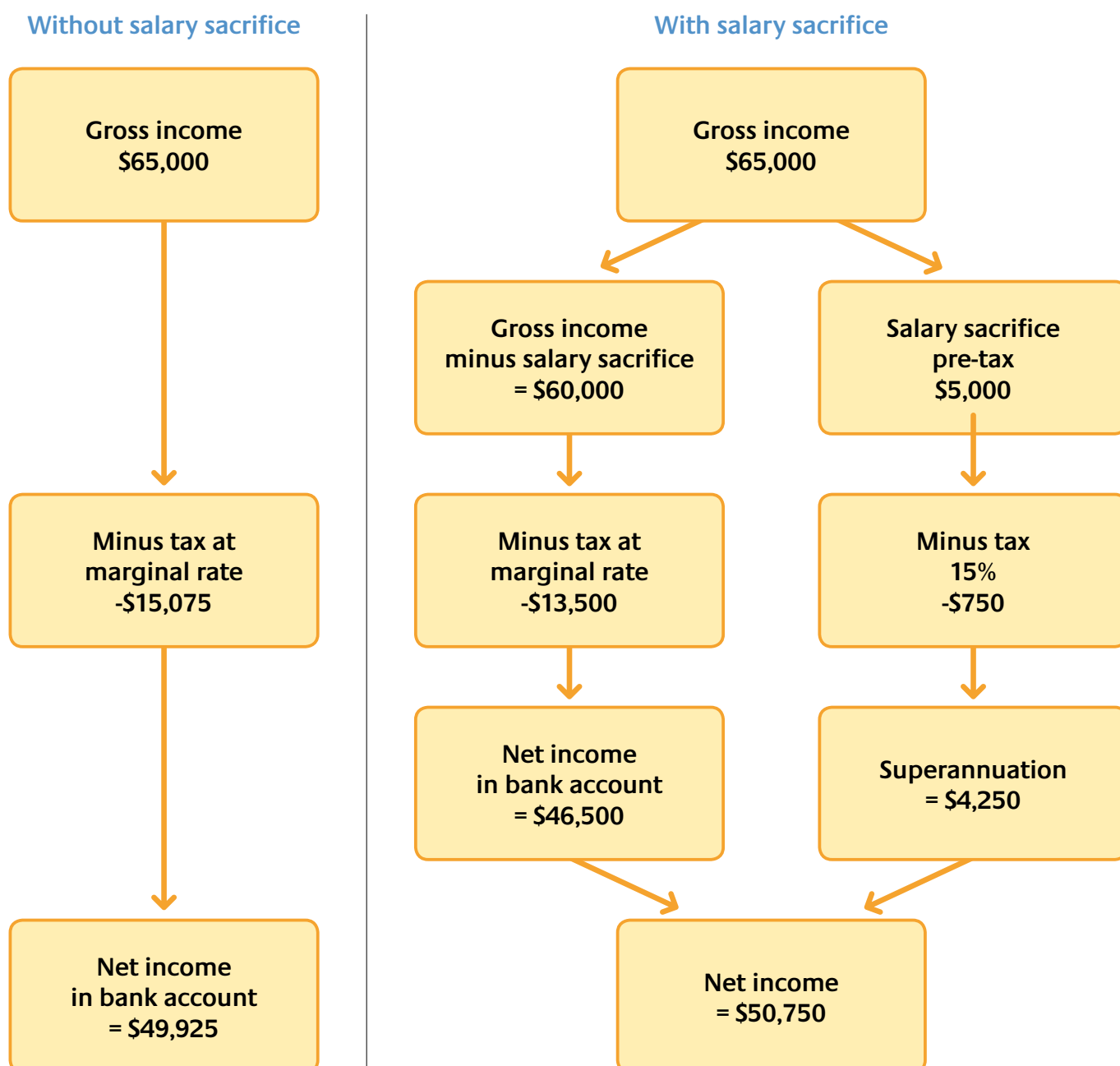
Let's look at an example

Say you are an individual earning a salary of \$65,000. On this amount, without salary sacrifice contributions to super, your income tax bill is around \$15,075 (including Medicare levy 2007/08 financial year).

Instead of taking the entire \$65,000 as cash salary, you elect to take \$60,000 as salary and instruct your employer to pay the remaining \$5,000 into super. Your pre-tax salary is now \$60,000 and you are taxed on this amount at your marginal tax rate, your income tax bill is around \$13,500 (including Medicare levy 2007/08 financial year).

The pre-tax super contribution of \$5,000 is now invested into your super fund. On this salary¹, and with the benefit of lower taxation rules that encourage us to invest into super, this contribution is taxed at 15% (equivalent to tax of around \$750). Your total tax bill, the sum of the income tax and contributions tax, is $(\$750 + \$13,500) = \$14,250$.

The pre-tax contribution to super has saved around \$825 in tax (\$15,075 less \$14,250). As a result, you have \$825 more invested for you than if you took that \$5,000 as normal pay, paid your normal amount of income tax and then invested what was left.



¹ Assumes the individual is an Australian resident who earns no other income. Tax rates for 2007/08 financial year and include the Medicare levy.

But there's more

Let's say you decided to salary sacrifice \$5,000 every year, and that your investments returned an average 7% pa. At the end of 20 years, you would have \$108,123. That is \$45,639 more than if you had taken the \$5,000 as cash salary and invested in a non-super investment with an identical return.

	Investment outside super (41.5% tax)	Salary sacrifice inside super (15% tax)
Salary sacrificed	\$5,000	\$5,000
After tax	\$2,925	\$4,250
Plus 7% return	\$205	\$298
Minus tax on performance returns	\$40	\$7
Financial position after year 1	\$3,090	\$4,541
Financial position after year 20	\$62,484	\$108,123

This table assumes pre-tax returns of 7% pa (income 4% pa, capital growth 3% pa). Assets are realised every five years and two thirds of any capital gains are taxed at 15% in super and 50% are taxed at a marginal rate of 41.5% outside of super. Income is 30% franked at the company tax rate of 30%. Results are adjusted for inflation of 2.5% pa. This table is for illustrative purposes only. A change to one or more of the variables and assumptions will produce different results. Your individual circumstances have not been taken into account.

And from 1 July 2007, super is even more effective for someone age 60 years or over. This is because tax on super lump sum payments (from a taxed super fund) will no longer apply, but tax will still be payable on non-super investments.

What to look out for...

While there are possible benefits from making additional contributions to your super fund via salary sacrifice, there are other points to consider before you do:

Preservation

All superannuation contributions must be preserved in the superannuation environment. This means that regardless of where the contributions come from (eg compulsory employer contribution, salary sacrifice, post tax employee contribution), you cannot access the money until you reach your preservation age, as shown below.

Your birth date	Your preservation age
before 1.7.1960	55
1.7.1960 – 30.6.1961	56
1.7.1961 – 30.6.1962	57
1.7.1962 – 30.6.1963	58
1.7.1963 – 30.6.1964	59
1.7.1964 or after	60

If you feel you may want access to this money before then, salary sacrifice may not be the most appropriate means of saving for you.

Contribution caps

There is a cap on the amount of salary sacrifice, other employer (and self-employed deductible) contributions (called concessional contributions) you can receive each year without paying higher rates of tax. For most people, the first \$50,000 of these contributions will attract the concessional tax of 15%. Should any further contributions be made, then tax will be charged at a total of 46.5% on the excess contribution. The \$50,000 threshold is an annual, per person cap. However, once you reach age 50, the annual cap is \$100,000 until 30 June 2012.

Tax on superannuation benefits

The amount of tax you pay on your benefits when you retire will depend on your age and whether you choose to receive your benefits as a lump sum or roll your benefits to an allocated pension. The amount of tax will also depend on the individual components that make up your benefit.

All super benefits, both lump sum and pension, are tax free if you are age 60 or over. But if you access your super before age 60 you will have to pay tax, although part of your benefit may be tax free.

Your Award or Enterprise Bargaining Agreement

It is possible that you are employed under an Award or Enterprise Bargaining Agreement which limits or prohibits salary sacrifice contributions. Your employer should be aware of this and will inform you if it exists.

How do you organise salary sacrifice super contributions?

Before implementing a superannuation strategy such as salary sacrifice, it is important to seek personal financial advice. This will ensure that you maximise the tax benefits from your super and other investments, and that you find the best way to save for the retirement you want.

Once you are comfortable with, and understand how salary sacrifice will affect you, it is necessary for you and your employer to draw up a formal agreement before you commence deducting super contributions from your gross income. As salary sacrifice contributions are made from your pre-tax salary,

when they are invested into your super fund they are treated exactly like 'employer' contributions. A formal agreement therefore establishes that these contributions will be entitled to the tax benefits that apply to superannuation. Once the agreement is in place, your employer can then organise through their payroll system for these pre-tax contributions to be made on your behalf.

Need more information?

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Alternatively, you can contact us:

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investments, please call 13 13 36

Enquiries about new
investments, please call 1300 360 645

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