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Strategy Watch | How to get more value from your salary

By Carly O'Keefe

A question that often arises when seeing a client is how should they invest additional funds.



Carly O'Keefe

A question that often arises when seeing a client is how should they invest additional funds. Should it be within superannuation, or should they invest outside of superannuation in a vehicle such as a managed fund?

In many cases, superannuation can deliver additional benefits that meet the needs of many individuals each with different circumstances. For example, individuals with lower incomes who receive at least 10% of their assessable income and reportable fringe benefits from eligible employment may be eligible to receive a Government co-contribution when they make a personal contribution to superannuation. For individuals who receive higher incomes who are ineligible for the co-contribution, they may choose to salary sacrifice to superannuation which will increase their net remuneration from employment.

This article aims to explore how superannuation salary sacrifice delivers benefits for both employees and employers. In addition, it compares the value of using superannuation as an investment vehicle versus a non-superannuation investment such as a managed fund.

It is very well established that superannuation has many tax concessions that make it an attractive investment vehicle. To begin with, a complying superannuation fund (that is in the accumulation phase) has a concessional tax rate of 15%. Therefore when a deductible contribution (eg superannuation guarantee and salary sacrifice) enters a superannuation fund it will be taxed at 15%. In addition, all investment earnings will also be taxed at the concessional rate of 15%. At the end of the process, when a member meets a condition of release and withdraws their benefit from superannuation, they will again receive concessional rates of tax on various eligible termination payment (ETP) components, if they do not exceed their reasonable benefit limit (RBL).

Due to these tax concessions, there are many

individuals (from low to high income earners) that salary sacrifice to superannuation. Salary sacrifice involves an employee forgoing future gross salary or wages, to receive employer superannuation contributions. Generally, for such an arrangement to be effective there must be a formalised agreement between the employee and the employer that is enacted before the salary sacrifice occurs (ie. it must be prospective) and the superannuation contribution must be made to a complying superannuation fund.

For employees, salary sacrifice may be an attractive solution as it can reduce their assessable income for taxation purposes, which means that portion which is being sacrificed, will not be subject to taxation in the hands of the employee. By utilising this strategy, in many instances, employees can increase their employment benefits as the salary that is sacrificed to superannuation will usually be taxed at 15%[^] when paid to superannuation compared to up to 47% plus Medicare levy if they received it in the form of salary.

[^]This does not include superannuation surcharge which may apply to individuals with an adjusted taxable income that exceeds \$99,710 (2004/2005 financial year). The maximum rate of superannuation surcharge is 12.5% (2004/2005 financial year).

Employees are not the only ones who can benefit from salary sacrifice as employers may be eligible to claim a tax deduction for those superannuation contributions. In some cases there are no limits to the amount that can be salary sacrificed. However, usually in such circumstances employers will salary sacrifice to a level where all employer contributions (ie. superannuation guarantee and salary sacrifice) do not exceed the individual's aged based limits as shown below. This is because any amount exceeding the relevant limit cannot be claimed as a tax deduction by the employer.

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Strategy Watch (Cont)

Age	Aged based limit
Under 35	\$13,934
35 – 49	\$38,702
50 and over	\$95,980

To determine how effective salary sacrifice is, it can be compared to the following alternative strategies:

- making personal (undeducted) contributions to superannuation; and
- saving through a non-superannuation vehicle such as a managed fund.



Example

Felicity, aged 32, is an engineer who receives a salary of \$90,000[^]. She wishes to start to save for her retirement and is in a quandary about whether she should invest additional funds in her superannuation account or if she should invest outside of superannuation in a managed fund.

She has sought advice from a financial adviser who has determined that based on her cash flow; she could afford to invest \$10,000 this financial year (and also possibly in the future).

Her financial adviser showed the following comparison of the various options she could choose to pursue:

- Option 1** Salary sacrifice \$10,000 to superannuation.
- Option 2** Make an undeducted contribution to superannuation.
- Option 3** Invest \$10,000 in a managed fund.

	Salary Sacrifice	Undeducted Contribution	Managed Fund
Surplus of salary	\$10,000	\$10,000	\$10,000
Income Tax*	NIL	\$4,700	\$4,700
Contributions tax	\$1,500	NIL	NIL
Net Investment	\$8,500	\$5,300	\$5,300

The first option of salary sacrifice delivers the best result for Felicity as it delivers a higher investment amount which means she will have more money working for her. In addition, all of the investment earnings will attract a lower tax of 15% in superannuation, whereas outside of superannuation she will be taxed at her marginal rate of tax, which is 47%*.

[^] This assumes Felicity is subject to a tax rate of 47%.

* This excludes Medicare Levy of 1.5%.

Please note this example does not take into account imputation credits that can be received by an individual (who has an Australian equity component in their managed fund) or superannuation fund (where the individual has selected an Australian equity investment option in the superannuation fund). This is because assuming that the asset allocation and level of franking is the same in the managed fund and the superannuation fund, the amount of imputation credits would be the same in each case.

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Strategy Watch (Cont)

When recommending that a client adopt a salary sacrifice strategy it is not appropriate to only do modelling, as the following questions also need to be considered to establish that the advice is suitable for the client.

- Will the client exceed their RBL?
- If the client will exceed their RBL, what strategies can they use to minimise the effect?
- Will the salary sacrifice attract superannuation surcharge?
- Does the client have sufficient surplus to implement the strategy?
- Will the client wish to access the money before retirement?
- Does the client wish to have diversification of investment vehicles to minimise legislative risk?

Who are your target clients?

- Employees who have the ability to enter into an effective salary sacrifice agreement with their employer.
- Employers who offer or wish to offer salary sacrifice benefits to their staff.

What are your opportunities?

- Contact clients and discuss the taxation concessions associated with superannuation.
- Contact employees who meet the target audience descriptions and discuss the need to accumulate savings for retirement.
- Show how individuals can have a higher investment amount through salary sacrificing in comparison to making an undeducted contribution or having an investment outside of superannuation.
- Compare the rate of the aged pension to the amount the client wishes to receive in retirement.
- Contact employers who wish to offer salary sacrifice as an employee benefit and discuss how this may be an attractive option for them to adopt and/or promote for their employees.

This is just one superannuation strategy that can be used. If you would like a marketing flyer and/or lead letter (see samples below) of this strategy please contact your Sales Manager in your state.

STRATEGY WATCH

It is very well established that superannuation has many tax concessions that make it an attractive investment vehicle. To begin with, a compulsory superannuation fund (CAF) is in the accumulation phase for a maximum term of 15% thereafter when a deductible contribution superannuation guarantee and salary sacrifice superannuation fund will be used. In addition, all investment earnings will also be taxed at the concessional rate of 15%. At the end of the period, when a member meets a condition of release and withdraws their benefit from superannuation, they will enjoy a concessional rate of tax on various eligible retirement benefits (ERBs) comprising, if they do not opt for a lump sum, the taxable (before tax) amount of the ERB.

Over the last few years, there has been an increasing number of employees who have opted for salary sacrifice to take advantage of the concessional rate of tax on various eligible retirement benefits. Salary sacrifice arrangements can be a valuable tool for employers to attract and retain staff, and for employees to increase their retirement savings. However, salary sacrifice arrangements will only be effective if they are a formalised agreement between the employer and the employee that is entered into before the salary sacrifice commences. To be a valid salary sacrifice arrangement, it must be a formalised agreement between the employer and the employee that is entered into before the salary sacrifice commences. To be a valid salary sacrifice arrangement, it must be a formalised agreement between the employer and the employee that is entered into before the salary sacrifice commences.

Age	Age Based Check
Under 20	\$1,000
20 - 24	\$1,500
25 and over	\$2,000

How to get more value from your salary

- Making concessional (deductible) contributions, superannuation and salary sacrifice through a superannuation fund can be a powerful tool.
- Making concessional (deductible) contributions, superannuation and salary sacrifice through a superannuation fund can be a powerful tool.
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What do I do now?

- No immediate action is required on your part. I will call you in the next few days so we can assess how this opportunity can be used to your advantage. In the meantime, if you have any questions, please contact our office on <xxxxx xxxxx Monday to Friday 8.30am-5.00pm (EST).>
- I look forward to discussing this opportunity shortly.

<Adviser details if not on letterhead>

Date

Private & Confidential

<Client Name>
<Client Address>
<Suburb, State, Postcode>

Dear <client name>

INCREASE THE VALUE OF YOUR SALARY THROUGH SALARY SACRIFICE

Did you know that you could get more value out of your salary through salary sacrificing to superannuation?

I am writing to advise you of an opportunity that may enable you to increase the value of your salary and save for your retirement at the same time, which you can take advantage of this financial year and in the future.

Our records indicate that you currently have superannuation with <insert name of superannuation provider>. In addition to ensuring that you still have the superannuation product and investment selection that best suits your needs, it may be worth discussing how salary sacrificing to superannuation may benefit you.

By adopting this strategy, maintaining your current standard of living in retirement may become more achievable, as you will be increasing the amount of your superannuation savings.

How does this work?

Taking advantage of this opportunity will involve you forgoing part of your salary which your employer will pay to your superannuation fund instead.

By adopting this strategy you will reduce the amount of your tax bill, as your income that is subject to taxation will reduce by the amount of salary that you sacrifice to superannuation. You will also benefit as the salary that is sacrificed to superannuation will, in most cases, only be taxed at 15% compared to up to <insert marginal tax rate of individual> plus Medicare levy if you receive it in the form of salary.

What do I do now?

No immediate action is required on your part. I will call you in the next few days so we can assess how this opportunity can be used to your advantage. In the meantime, if you have any questions, please contact our office on <xxxxx xxxxx Monday to Friday 8.30am-5.00pm (EST).>

I look forward to discussing this opportunity shortly.

Yours sincerely

<Insert Adviser's name>
<Authorised Representative/ Representative>
<Insert authorised representative number if applicable>

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Market Update

The Local Game

By Guy Hutchings – TOWER Australia, Chief Investment Officer

Australian shares remained the "only game in town" in the December quarter as the local market rally gathered pace. The 'magic' 4000 mark on the Stock Exchange index came and went.

This was largely driven by continuing signs of solid economic growth flowing through to the majority of company earnings. Takeovers, new listing activity and a strong resource rally also added fire.

In addition, investors took in comments from companies indicating that any cyclical peak in earnings may be pushed out into 2006.

This fairly positive scene, against a backdrop of steady cash rates, falling long bond yields and overseas markets holding together relatively well, has produced an inflow of funds into equities. In contrast, the prospects for residential property and fixed income securities have been seen as uninspiring.

The December highs in the market saw quarter returns for shares and listed property at 11.4% and 10.6% respectively. Over the year the local market was up 28% for shares and 32% for listed property.

Going into 2005, investor sentiment remains strong with enthusiasm unaffected by significant uncertainties overseas including increasing US interest rates, instability in the oil price, record trade deficits and high consumer debt levels.

On balance, patience may prove to be a virtue in 2005. Capital preservation and less exuberant returns may overtake the pursuit of accumulation in the minds of some investors.

Resource stocks have also been in the limelight lately with increasing momentum based on a good rebound with some commodity prices, some fairly solid earnings results, significant takeover activity and successful exploration reports.

Current valuations now look pretty full and a pause may be inevitable. However, the longer term trend remains broadly favourable due to a combination of demand factors, most notably the prospective growth in Asia in the next decade, and the natural delay in ramping up production to meet sustained growth in the years ahead.

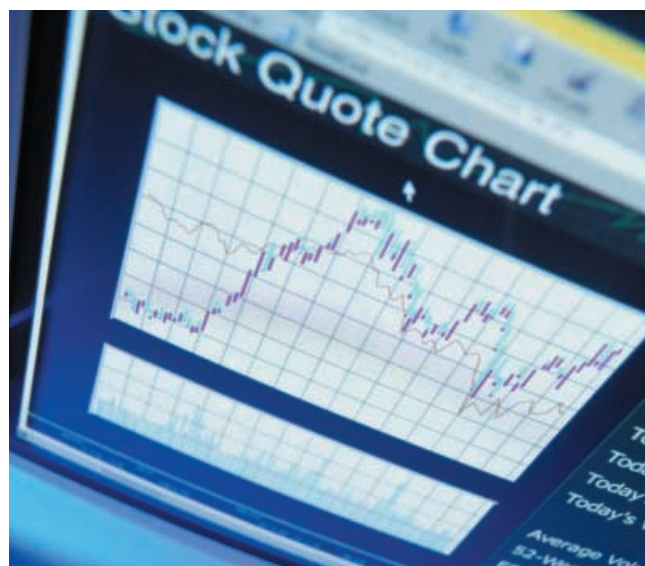
In contrast to domestic stocks, overseas markets had positive but varied performances over the quarter based on concerns over inflation, unstable oil prices and rising interest rates.

For local investors, the MSCI World Share Index was up 8.3% in foreign currency terms and, as the \$A rallied returned 3.8% after conversion to the local dollar. The US and most European markets were solid performers for the quarter but have lagged the local one during 2004.

On these fundamentals I remain cautious for the prospects of a sustained bull market in 2005 and continuation of the current optimism.

I would counsel investors to review their investments and consider rebalancing portfolios toward their longer term strategic allocation to local shares and listed property.

While there appears to be a growing perception that interest rates may continue at present exceptionally low levels for a while, which is positive for stocks short term, the external economic environment is still mixed - as is the guidance from overseas companies on the strength of their earnings growth.



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Guy Hutchings