ECLIPSE ADVISORY
Chartered Accountants

Salary sacrifice and super: How does it work?

While the sacrificing bit might sound painful, salary sacrifice is all about giving up something now to get an even bigger financial benefit later on.

Salary sacrificing goes by many names, including salary packaging and total remuneration packaging, but the meaning is the same. Salary sacrifice is when an employee chooses to set up a special arrangement with their employer to forgo part of their salary or wage to help pay for a range of benefits like cars, school fees or extra super contributions.

If you decide to sacrifice some of your salary into your super account, you make an agreement with your employer for them to pay some of your pre-tax salary straight into your super fund, rather than into your bank account with the rest of your salary where it will be subject to tax.

How do you benefit from salary sacrificing?

Setting up a salary-sacrifice arrangement can be a great way to save extra for your retirement and potentially improve your financial position. The main benefits are:

1. Less tax on contributions

As salary sacrifice contributions come from your pre-tax salary, you only pay 15% tax on them when they enter the super system (if you earn less than $250,000) or 30% (if you earn over this amount).

This is a lower tax rate than most employees pay on their income (which can be as high as 47% with the Medicare levy in 2022–23), so these types of arrangements can be a good way to reduce your tax bill.

2. Lower tax on investment earnings

Your super fund pays a maximum of 15% on investment earnings compared with your marginal tax rate outside the super system (up to 47% with the Medicare levy in 2022–23).

3. Reduced taxable income

By putting more of your salary into your super account, you reduce the amount of income on which your income tax is calculated. This could mean you end up paying less tax.

5 things to consider before deciding to set up a salary-sacrifice arrangement for super

Salary sacrificing into your super account can be a great way to build your retirement savings and lower your tax bill, but it may not be the best strategy for everyone. Here are some things to consider before setting up an arrangement with your employer:

1. Your debt level

If you have large debts, salary sacrificing into super means you will have less after-tax income to pay your debts.

2. Ineffective for low-income earners

If your income is under $18,201, a salary-sacrifice arrangement won't save you any tax, as there is no tax paid at this income level.

In 2022–23, the income tax rate on income between $18,201 to $45,000 is 19.0% – compared to 15% for a super contribution – so you receive a small tax benefit if you put a salary-sacrifice arrangement in place for some of your income.

For those on higher incomes, the tax benefit received from sacrificing some of your salary into your super account is more attractive. For example, if your annual income is between $45,001 and $120,000 in 2022–23, the tax rate on income between these two amounts is 32.5% – compared to 15% for a super contribution.

3. Impact on salary benefits

Salary sacrifice changes your salary level. It may mean benefits such as your holiday loading and overtime are lower, as your salary amount is lower.

4. No deductions or tax offsets

Salary sacrificed amounts cannot be claimed as tax deductions and you do not receive tax offsets for sacrificed amounts.

5. Concessional (before-tax) contributions cap

Salary-sacrificed amounts are counted towards your annual concessional (before-tax) contributions cap ($27,500 in 2022–23), so you need to take care not to exceed your cap (the maximum amount you can contribute concessionally).

How to salary sacrifice into your super account

Step 1: Talk to your employer and find out if they offer these arrangements, as not every organisation does.

Step 2: Ensure you set up the salary-sacrifice arrangement with your employer before you start the work, which usually means before the start of the financial year in which you plan to start salary sacrificing into your super account.

If the arrangement is not put into place until after you have performed the work, it may be ineffective. This means you can't decide in April or May you want a salary-sacrifice arrangement to cover pay already received during the current financial year.

Step 3: Ensure the arrangement is in writing and clearly states all the terms of the salary-sacrifice agreement, such as the amount you want to contribute and when your employer will make the contributions into your super account. Some employers only make SG contributions every quarter, but if you are paid fortnightly or monthly, your contributions could go into your super account then. That way you start earning investment returns immediately.

Step 4: Ensure your super fund receives all your salary-sacrifice contributions from your employer prior to 30 June, or they will be counted towards your concessional contributions cap for the next financial year.

Similar but different: Salary sacrifice and personal tax-deductible super contributions

As an employee, you have a choice between using a salary-sacrifice arrangement to top up your super or making a personal super contribution and claiming a tax deduction in your annual income tax return.

Both salary-sacrifice and tax-deductible personal super contributions are classed as concessional (before-tax) contributions. Your annual cap for these types of contributions is $27,500 (2022–23).

9 things to consider when comparing the two strategies:

1. Not all employers offer salary-sacrifice arrangements.
2. Once you set up a salary-sacrifice arrangement you don't need to do anything else during the year.

3. With salary sacrifice you receive the tax benefit immediately as part of your take-home pay, while with a personal contribution you have to wait until you lodge your annual tax return.
4. If you work casually or have an irregular work pattern, salary sacrifice may be unsuitable as you can’t alter your contribution amount between pay periods.
5. Reducing your taxable income with a salary-sacrifice arrangement may affect other benefits you receive, like overtime or holiday loading.
6. Your employer may not process your salary-sacrifice contribution into super for up to three months, making it difficult to monitor your concessional (before-tax) contributions cap.
7. An unexpected pay increase or bonus could mean your salary-sacrifice arrangement could take you over the concessional contributions cap.
8. Personal contributions can be made as a lump sum at any time during the financial year, giving you flexibility if your income changes.
9. With personal contributions, you can choose how much you want to contribute across the financial year and the amount you want to claim as a tax deduction.