Recent Changes to Super Intensify the Value of Salary Sacrificing

By Andrew Proebstl, Chief Executive, Legalsuper

From 1 July 2009 the Federal Government halved the amount of super you can contribute, inclusive of the mandatory nine per cent Superannuation Guarantee Contribution ('SGC'), during a financial year.

This means Australians now need to save incrementally over longer periods to fund their retirement saving goals, rather than topping up their super with larger amounts over a shorter period closer to retirement.

In terms of the Government's changes: for over-50s the previous $100,000 per year concessional contributions cap is now $50,000, and for under-50s the previous $50,000 per year cap is now $25,000. In three years' time the $50,000 per year cap for over-50s will also be reduced to $25,000 to match under-50s. (Concessional contributions include SGC, salary sacrifice and contributions for which a tax deduction is claimed and which are very popular amongst self-employed practitioners).

These changes will hit higher income earners in particular, who generally speaking have higher aspirations in retirement and therefore need to save larger amounts.

However, salary sacrificing is a strategy many employed Australians should consider to manage these changes. With salary sacrificing you can save incrementally on top of your nine per cent SGC.

One salary sacrificing approach worth considering is allocating one per cent of each pay increase you receive into additional salary sacrifice contributions. Thus, after one salary increase the standard nine per cent is increased to 10 per cent, then to 11 per cent the following pay increase, and so on until you reach the contribution cap based on your age as outlined above. Small incremental increases like this over time are also far less likely to have pressures on your standard of living.

If you earn $75,000 and save just an extra one per cent per year ($750) this would accumulate to $18,000[1], in today's dollars, over 20 years.

A key benefit of salary sacrificing is that the resultant savings are only taxed at 15 per cent. This is much lower than the tax rates paid by income earners earning above $35,000, where three tax rates exist at 30 per cent, 38 per cent and 45 per cent respectively.

This is a significant tax benefit and gives you at least a 21 per cent head start on your savings than if you received your income in your hands. Another way to consider the tax advantage is that the super fund in which you are investing would have to fall by at least 18 per cent for you to be worse off than if you received the money as income in your hands.

A further benefit of salary sacrificing is that incremental savings over longer periods enjoy the benefits of compounding earnings. Every year that your savings are invested and earn money, the profits are reinvested, in turn earning you more profits the next year. This compounding cycle makes your savings grow exponentially and superannuants who top up their savings later in life will miss out on it.

Finally, contributing incrementally over longer periods through salary sacrificing is aligned with another powerful investing principle known as 'dollar-cost-averaging'. By regularly investing you smooth out the market's ups and downs, reducing your exposure to the risk of investing at the wrong time, such as when investment markets are overpriced.

Salary sacrificing has always provided significant advantages over topping up super later in life, however, recent government changes to contribution caps mean the advantages are even more compelling. I would encourage you to further consider the advantages of salary sacrifice in light of these recent changes.

Further information about salary sacrificing, may be downloaded from our website at www.legalsuper.com.au, or email us and we'll send you a copy.

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1. Calculated using the 'Superannuation Calculator' available at www.asic.gov.au. Assumes a starting age of 40 and a time period of 20 years. Other assumptions include: $50,000 starting balance, 9% SGC, 8% gross investment return, 2.5% inflation, 1% annual fee.