



WealthAdviser

TOP 9 THINGS TO KNOW ABOUT SALARY PACKAGING



AND MISTAKES TO AVOID

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Before you get started

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Information in this handbook is no substitute for professional financial advice.

We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this handbook you will find information about our authorised representative and how to go about booking an appointment.

If ultimately you decide not to meet with us we still encourage you to consult with another suitably licensed and qualified financial adviser.

In any circumstance, before investing in any financial product you should obtain and read a Product Disclosure Statement and consider whether it is appropriate for your objectives, situation and needs.

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Letter from the Wealth Adviser Library

Dear Reader

Welcome to the Wealth Adviser Library

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

Knowledge gives you a huge advantage

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That's why our team of experts has created this series of digital handbooks and manuals that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

Take the next step

Wealth Adviser (a division of WT Financial Group Limited) supports more than 400 privately owned and operated advice practices around the country. We invite you to engage with one of our advisers to discuss what it was you were hoping to achieve when you obtained this handbook, and to establish if they can help you achieve your goals and objectives.

At the rear of this handbook you will find details on how to book an appointment.

Wealth Adviser Library

Introduction

The purpose of this eBook is to provide information to help you understand salary packaging. As with any financial decision, we recommend you seek professional advice to determine if salary packaging is appropriate for your financial circumstances.

In general, salary packaging is usually more appropriate for people on medium to high incomes.

There are no restrictions on the type of benefits that can be provided as part of a salary packaging arrangement. The types of benefits provided typically fall into three broad categories:

1. Superannuation
2. fringe benefits
3. exempt benefits.

Most employers will offer salary packaging options that provide the opportunity for all employees to salary sacrifice into superannuation. The other two categories, fringe and exempt benefits, may only be available to some employees, if at all.

We will now look at each of the three categories of salary packaging benefits, as well as the associated tax implications.

In this eBook, we will explain what salary packaging is, the benefits, and how it works. Also covered are the common types of benefits that you can package and specific special salary packaging benefits for employees who work for not-for-profit organisations. We will also explain some salary packaging mistakes to avoid.

Note

The rates referred to in this eBook apply to the 2016/17 FBT year. This rate includes

- Medicare Levy is 2%.
- A temporary 2% budget repair levy applies to taxable incomes of greater than \$180,000 from 1 July 2014 to 30 June 2017.

What is salary packaging?

Salary packaging is an arrangement between an employer and employee, where the employee agrees to sacrifice part of their future salary or wages in return for the employer providing them with another benefit (or benefits) of similar value.

Salary packaging is usually available for permanent and part-time employees, depending on the employer. It is important to note that the sacrificed salary must actually be sacrificed for the agreed duration. -In the case that the fringe benefit has actually not been provided and the amount is cashed out at the end of a salary sacrifice arrangement accounting period, the amount cashed out is salary and is taxed as normal income.

It is recommended that salary packaging arrangements be in writing, to avoid any future confusion on the part of both employees and employers. Salary packaging arrangements can be renegotiated at any time, subject to the terms and conditions of any employment agreements or industrial awards. Employment contracts are required to include an employee's remuneration details, including any salary packaging arrangement.

From the Australian Taxation Office's (Tax Office) perspective, salary packaging arrangements must be put in place before the work is performed by an employee, not retrospectively.

Benefits of salary packaging

Salary packaging can be a smart way for an employee to maximise their after tax income. Without salary packaging tax is deducted from an employee's salary and the net income can be spent or saved. With salary packaging however, the employer can pay the employee the same salary, but pay some of the employee's expenses using pre-tax dollars, potentially providing the employee with an overall greater net benefit.

Salary packaging arrangements reduce an employee's wage or salary and therefore

the amount of income tax that they pay.

Salary sacrifice arrangements are particularly effective for taxpayers on the highest marginal rate as the tax benefit arises where the fringe benefit provided by the employer is taxed concessional under the fringe benefits tax (FBT) regime. As a result, although the amount of salary that has been sacrificed equals the cost to the employer of providing the benefit, the cost of the benefit to the employee is less than if the employee used after-tax salary to obtain the same benefit.

However, salary packaging can still be tax-effective for those on lower marginal rates as:

- there are a number of FBT-exempt benefits
- there are a number of fringe benefits that receive concessional FBT treatment
- some employers are exempt from FBT
- some employers have concessional rates of FBT apply to them.

Superannuation

It is compulsory for employers to pay the superannuation guarantee (SG) contribution to superannuation on behalf of their employees (with limited exceptions). Some employers may pay an additional amount over and above the required superannuation guarantee contribution on their employee's behalf for all employees.

Many employers in Australia offer the option for employees to make additional voluntary contributions to superannuation under a salary packaging arrangement, instead of receiving the equivalent amount as salary or wage. This is commonly referred to as 'salary sacrifice' contributions. These are 'pre-tax' contributions, whereby the individual does not pay tax at their individual marginal tax rate on the contributions, but instead the contributions incur 15% tax upon entry into the superannuation fund (commonly referred to as 'contributions tax').

Employer contributions, which include the SG, additional employer contributions, and salary sacrifice amounts, are classed 'concessional contributions'. There are limits on the concessional contributions that can be made each year and amounts contributed over this cap may incur excess tax.

Note that high-income earners may also incur an additional tax on their concessional superannuation contributions, referred to as Div 293 tax.

Salary sacrifice to superannuation will result in employees on a marginal tax rate greater than 15% paying less tax overall, because of the comparable tax rate to get the money into superannuation -15%. Except for the Div 293 tax mentioned above.

Note that these contributions are not regarded as fringe benefits and are therefore not subject to FBT. However, if the contributions are made to a person other than the employee (e.g. to a spouse), the contributions are regarded as a fringe benefit and are taxed according to the FBT rules.

Case study - How Does the Maths Work?

Imagine that you currently earn a gross salary \$80,000 per year and you want to compare your income tax obligation both with and without sacrificing \$10,000 of your gross salary into superannuation instead.

The calculations are outlined below:

Without Salary Sacrifice:

Gross salary: \$80,000 Tax: \$17,547

With Salary Sacrifice:

Gross salary: \$70,000 Tax: \$14,297

In the above example, a salary sacrifice of \$10,000 lowers the tax obligation by \$3,250. In exchange for that, the employee will be provided with a benefit valued at \$10,000 into their super, less \$1,500 contributions tax.

Fringe Benefits and Fringe Benefits Tax (FBT)

Fringe benefits tax (FBT) is a tax payable by employers on the value of certain benefits provided to employees (or their associates) in respect of their employment, known as 'fringe benefits'. FBT is tax deductible to the employer and any fringe benefits that incur FBT do not also incur income tax by the employer.

The FBT year (for Tax Office and reporting purposes) runs from 1 April to 31 March.

The taxable value of the fringe benefit as well as the FBT is deducted from the employee's remuneration package for the purposes of calculating their income tax payable (and their marginal tax rate).

From 1 April 2015, the FBT rate is 49% and will apply through to the FBT year ending 31 March 2017. For the FBT year from 1 April 2017 to 31 March 2018 the FBT rate will revert to 47%, when the 2% Temporary Budget Repair Levy ceases.

The FBT is calculated by "grossing-up" the taxable values of fringe benefits provided during the FBT year. The gross-up has the effect that FBT is calculated as if the employer provided fringe benefits with a taxable value that included the FBT paid by the employer.

The taxable value of a fringe benefit is reduced by the amount of any payment by the employee towards the fringe benefit and by the amount that would be deductible if the employee incurred the expense ('otherwise deductible' rule). The grossed up value of an employee's fringe benefits must be reported by an employer on the employee's annual payment summary (previously group certificate), if the taxable value exceeds \$2,000 in an FBT year. This amount is not added to the employee's taxable income, but is considered in assessing the employee's eligibility for measures such as the Medicare levy surcharge, tax offsets, child support payments, government offsets and other benefits.

The 12 different categories of fringe benefits are:

1. car fringe benefit e.g. that employees may drive for personal use
2. debt waiver fringe benefit
3. loan fringe benefit
4. expense payment fringe benefit e.g. employee loan repayments, school fees, child care, health insurance or home phone costs
5. housing fringe benefit
6. living away from home fringe benefit
7. board fringe benefit
8. meal entertainment fringe benefit e.g. dine-in restaurant meals for two or more people, but not takeaway food), up to capped limits
9. tax-exempt body entertainment fringe benefit
10. car parking fringe benefit
11. property fringe benefit e.g. goods, land, buildings, shares and bonds
12. residual fringe benefit (any fringe benefit that is not subject to any of the other rules).

FBT legislation specifies how the taxable value of the different types of fringe benefits is to be determined. There are also certain types of expenses that are considered "non-reportable" fringe benefits that are not required to appear on an employee's end of year payment summary. These are discussed further on in this eBook.

Novated lease – fringe benefit in focus

A common way to provide a car is via a novated lease, as this allows the vehicle to be used for both personal and work use and a tax efficient way for an employee to purchase a car and save money.

A novated lease involves the employee leasing a car from a finance company and signing a novation agreement with their employer. The employer is then responsible for making the lease payments to the finance company. The employer may set up

a maintenance agreement with a vehicle maintenance firm. The employer makes monthly payments to this firm that then pays all pre-agreed expenses including petrol, maintenance and repairs, insurance, registration and servicing.

The employer can pay operating costs using various methods, such as invoice by the provider, employee paying and then being reimbursed, or the employee paying using the company credit card. Depending on the amount of business use and the employee's marginal tax rate, employees are often better off receiving a car from their employer than paying for one out of their after-tax salary.

The vehicle is regarded as a fringe benefit for taxation purposes. FBT is paid based on a Tax Office formula to determine the value of the car. The amount of FBT can be reduced by the employee making some of the repayments from their post-tax salary.

Most novated leases tend to run for a periods of three to five years. At the end of the lease, the employee usually has three options:

1. arrange a new car with a new novated lease
2. extend the novated lease on the existing car
3. purchase the existing car at its residual market value.

Case study - novated lease for Rodger

The following table illustrates how salary sacrificing and making an employee contribution towards the cost of running a motor vehicle work by comparing the net disposable income for Rodger in the following two scenarios.

1. no salary packaging arrangement
2. a salary packaging arrangement where an employee contribution is made.

Rodger earns \$100,000 per year. He is

considering entering into a novated lease arrangement to acquire a family sedan costing \$65,000. The annual running costs are estimated to be \$21,000 (including GST). This includes finance payments, fuel and oil, insurance, service and maintenance, registration and tyres.

The taxable value of the car fringe benefit is equal to the cost of the car multiplied by the statutory fraction of 20%. In this case this is $\$65,000 \times 0.20 = \$13,000$. If Rodger makes an employee contribution equal to the taxable amount of \$13,000 no FBT will be payable.

Otherwise, FBT is payable on the taxable amount and deducted from Rodger's package.¹

Rodger will be able to achieve an increase of net disposable income of \$3,120 per year by salary packaging the car and making an after tax employee contribution of \$13,000.

Note that this example ignores the impact of Goods and Services Tax (GST), input tax credits and the luxury car tax threshold.

¹ FBT calculated as the taxable value X gross-up factor X FBT rate. This assumes a Type 1 employer (entitled to a goods and services tax (GST) credit in respect of the provisions of a benefit. The FBT rate for the period ending 31 March 2017 is 49%.

	1. Salary only (no packaging)	60% of Income \$
Gross income	\$100,000	\$100,000
Less motor vehicle package value	Nil	\$8,000
Less FBT	Nil	Nil
Taxable income	\$100,000	\$92,000
Less income tax (2016/17 rates)	\$24,632	\$21,672
Less 2% Medicare	\$2,000	\$1,840
Income after tax and salary sacrifice amount	\$73,368	\$68,488
Less employee contribution	\$21,000	\$13,000
Net disposable income	\$52,368	\$55,488
Net packaging benefit per year		\$3,120
Total benefit over 5 year lease		\$15,600

Exempt benefits

As the name implies, exempt benefits under a salary packaging arrangement are technically not 'fringe benefits' and so not subject to FBT. These types of employee benefits are generally appealing to employers because they don't increase their tax burden with additional FBT obligations.

In house fringe benefits

The first \$1,000 of the taxable values of certain "in-house" benefits given to an employee (or their associate) in a year is

exempt from FBT, except if specifically provided under a salary packaging arrangement. The benefits to which this applies are:

- In-house property fringe benefits — generally, goods and other property provided to employees which are of a kind that the employer sells in the ordinary course of business
- In-house residual fringe benefits — generally, services and other residual benefits provided to an employee which are of a kind that the employer provides in the ordinary course of business
- In-house expense payment benefits — where the expenditure to which the benefit relates was incurred by an employee in acquiring property or other benefits of a kind that the employer provides in the ordinary course of business.

Reimbursement of car expenses

Reimbursement of car expenses on a cents per kilometre basis is exempt if the amount is within the prescribed rates.

Work related items

Below are typical work-related items that can be provided under salary packaging arrangements:

- portable electronic devices (e.g. laptop or tablet computers, mobile phones).
- computer software
- protective clothing
- tools of trade
- briefcases

Generally, only one type of item that has a similar function is able to be an exempt benefit under salary packaging arrangements. For example, only one laptop computer would be an exempt benefit.

Other FBT exemptions

Other examples of exempt benefits include (with certain requirements to be met in each instance):

- work-related newspapers and business journals
- relocation expenses for employment purposes
- work-related membership and fees, such as corporate airport lounge membership
- compassionate travel
- employment interviews (current or future employment), including accommodation, flights and meals
- student exchange programs
- fly in fly out arrangements (transport to and from an employee's home base and a remote area worksite such as a ship)
- taxi travel ending or beginning at place of work; or travel as a result of sickness
- travel for medical treatment
- remote area housing.

Exempt and not-for-profit organisations

There are specific exemptions for the following employers:

- Religious institutions -for benefits provided to a minister or full-time member of a religious order in respect of that person's religious work
- International bodies -that are exempt generally from taxation
- Foreign government representatives -that are exempt under the Consular Privileges and Immunities Act 1972 or the Diplomatic Privileges and Immunities Act 1967
- Public benevolent institutions and certain hospitals -the exemption does not extend to benefits provided by a state department of health to an employee whose duties are not exclusively performed in connection with a public hospital.

Public benevolent institutions, hospitals and health promotion charities

Benefits that are exempt for these institutions are limited in the amount of concessional treatment they attract. The FBT exemption applies if the total grossed-up value of certain benefits is equal to, or less than, the capping threshold. If this exceeds the capping threshold, the employer organisation will need to pay FBT on the excess.

Types of organisations eligible for FBT exemption	Capping threshold*
Public benevolent institutions (PBIs) (other than hospitals)	\$30,000 per employee
Health promotion charities (HPCs)	\$30,000 per employee
Public and not-for-profit hospitals	\$17,000 per employee
Public ambulance services	\$17,000 per employee

*For the FBT years ending 31 March 2016 and 31 March 2017 the capping threshold changes from \$17,000 to \$17,667 and from \$30,000 to \$31,177.

Source: <https://www.ato.gov.au/Non-profit/your-workers/obligations-to-workers/fringe-benefits-tax/fbt-concessions/fbt-exemption/only>

Note that the cap applies even if the employee is employed for part of the year only.

Benefits provided by public benevolent institutions and health promotion charities only attract concessional treatment if they are endorsed by the Tax Commissioner.

Rebate for certain Non-Profit Employers

Certain non-profit organisations are entitled to a rebate of 49% (for the FBT years ending in 31 March 2016 and 31 March 2017) to ensure these institutions aren't disadvantaged as they are not entitled to

any other tax deductions.

These 'rebatable employers' are those that are not a public benevolent institution or health promotion charity and include

- trade unions
- certain scientific or public educational institution (other than an institution of the Commonwealth, a state or territory)
- certain charitable organisations.

Rebatable employers are entitled to have their liability reduced by a rebate only equal to 49% of the gross FBT payable subject to a \$30,000 capping threshold (or increased threshold for the 31 March 2016 and 31 March 2017 FBT years). If the total grossed-up taxable value of fringe benefits provided to an employee is more than these thresholds a rebate cannot be claimed for the FBT liability on the excess amount.

Effectively, this means that part of a not-for-profit employee's wages can be paid as a reimbursement of personal expenses under a salary sacrificing arrangement, with no income tax or FBT is payable on, up to the prescribed thresholds.

Mistakes to avoid

1. Exceeding Capped Limits.

As was outlined earlier in this eBook, there are capped limits for certain salary packaging/sacrificing benefits (such as additional superannuation contributions, meal entertainment and holiday benefits, as well FBT exemption claims by not-for-profit sector employees). Exceeding these limits potentially reduces the tax effectiveness of the associated salary packaging decision.

2. Not Declaring Reportable Fringe Benefits.

Employers and employees need to be aware that any benefit provided to an employee in connection with their work, that also has a private use, is potentially subject to FBT. For example, a company vehicle that is

garaged each night at an employee's residence is potentially a fringe benefit, if the employee is able to use the car to travel to work each day. Employers are legally required to report fringe benefits valued at over \$2,000 in a financial year on an employee's payment summary (group certificate). Failure to do so risks fines and penalties.

3. Employees Not Keeping Sufficient Expense Reimbursement Records in the Not-For-Profit Sector.

In order to claim the additional FBT exemptions to which they are entitled, not-for-profit sector employees must keep relevant expense records to substantiate their claims such as statements and receipts. The expenses claimed can include large bills like mortgage or other loan repayments, rent, school fees and credit card statements. Employees that fail to do this run the risk of not being compliant and having their FBT exemption claim rejected by the Tax Office.

Take the next step

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We now invite you to take the next step and meet with an adviser to discuss what it was you were hoping to achieve when you downloaded this handbook and to establish if we can help you achieve your goals and objectives.

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We look forward to meeting you soon.

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