

Cliftons – THE Business Specialists

SALARY SACRIFICE

Salary sacrifice has, over recent years, become an increasingly popular way for employees to have items paid out of pre-tax income, therefore getting the item cheaper than if they were buying it out of their after-tax income.

It is extremely popular in the health system and for religious practitioners, due to the benefits of tax free and fringe benefits tax exempt status. There are some limits for those people, but generally the concept is quite attractive.

The popularity of salary sacrificing for other employees where the employer is liable for both income tax and fringe benefits tax is less so, especially for employees who are on marginal tax rates less than the maximum of 48.5%. This is due to fringe benefits tax being paid by employers at the top rate of 48.5% after grossing up the benefit, and then wishing to recover the out of pocket expense from the employees gross wage.

	Provider 30% Tax		Provider 0% Tax		
	GST	No GST	GST	No GST	
Benefit	2,200	2,200	2,200	2,200	
GST	200	0	200	0	
Net Deduction	2,000	2,200	2,000	2,200	
Gross Up Rate	2.1292	1.9417	2.1292	1.9417	
Grossed Up Benefit	4,258	4,272	4,258	4,272	
FBT Rate	48.5%	48.5%	48.5%	48.5%	
FBT Payable	2,065	2,072	2,065	2,072	
Cost to Provider	4,065	4,272	4,065	4,272	allowed as deduction
Tax Saving to Provider	1,220	1,282	0	0	due to deductibility
After Tax Cost to Provider	2,846	2,990	4,065	4,272	
Therefore, reduction of employee gross wage	2,846	2,990	4,065	4,272	to recover so provider
Tax Rate	31.5%	31.5%	31.5%	31.5%	is not out of pocket
Tax on Wage Reduction	896	942	1,281	1,346	
Wage Out Of Pocket	1,949	2,048	2,785	2,926	
Original Benefit Cost	2,200	2,200	2,200	2,200	
Employee Benefit or Out Of Pocket	251	152	-585	-726	

The above example shows how salary sacrificing works, and the net benefit to the employee are following. In the example the assumption is made that the employer is liable for fringe benefits tax. For detailed information on other situations please contact Cliftons.