

Federal Budget 2010: IOOF Adviser Special Bulletin

Well we were fairly warned that this would be a no frills Budget and the Treasurer delivered just that – no frills. Other than a modest tax sweetener for interest bearing accounts, there wasn't much in it for superannuation and financial services, as all the big ticket announcements had already been made when the Henry Tax Review was released last week. That is: the increases to the Superannuation Guarantee rate to 12 per cent and the \$500 super contribution tax rebate for low income earners etc. There was, however, a sneaky sting in the announcement that the reduction in the super co-contribution to (a maximum of) \$1000 would now be permanent.

Fiscal responsibility and bringing the Budget back to surplus within three years were the key messages. Infrastructure got some airplay (mentioned in the Budget speech 12 times) whereas poor old 'working families' didn't rate a mention until eight minutes into the Budget speech (and was only mentioned five times in total). For financial planners, the key measures in this Budget are set out below.

Taxation

Current tax thresholds from 1 July 2009 tax thresholds Income range (\$)	Tax rate (%)	New tax thresholds from 1 July 2010 tax thresholds Income range (\$)	Tax rate (%)
0 – 6,000	0	0 – 6,000	0
6,001 – 35,000	15	6,001 – 37,000	15
35,001 – 80,000	30	37,001 – 80,000	30
80,001 – 180,000	38	80,001 – 180,000	37
180,001 +	45	180,001 +	45

New tax thresholds from 1 July 2010 tax thresholds Income range (\$)	Tax rate (%)	Tax payable (Resident)
0 – 6,000	0	Nil
6,001 – 37,000	15	Nil + 15% of excess over \$6,000
37,001 – 80,000	30	\$4,650 + 30% of excess over \$34,000
80,001 – 180,000	37	\$17,550 + 40% of excess over \$80,000
180,001 +	45	\$54,550 + 45% of excess over \$180,000



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From 1 July 2010, the low income tax offset (LITO) has been increased from \$1,350 to \$1,500. Those eligible for the full LITO will not pay tax until their annual income exceeds \$16,000 (up from \$15,000). The LITO will be based on:

Taxable income	Tax offset
< \$30,000	\$1,500
\$67,500 & over	NIL

Comment: A client with an income above \$37,000 pa but less than \$80,000 pa will receive an extra \$300 in after-tax income next financial year, whilst high income earners with an income of \$180,000 pa will receive an extra \$1,300 in after-tax income.

Before this money is spent on a holiday or making extra mortgage repayments, clients may wish to consider salary sacrificing into superannuation to put this extra income to good use as part of their wealth retirement savings.

Your clients can salary sacrifice the tax cuts into superannuation whilst maintaining their after-tax income to fund their current standard of living. The demonstrated and well known advantage of salary sacrificing into superannuation will avoid personal income tax rates being applied and access the maximum super tax rate of 15 per cent on the contributed amount.

For a client who is earning \$80,000 pa, the opportunity exists to salary sacrifice \$438 into superannuation (ie $\$300/[1 - 31.5\%]$) without reducing after-tax income. On the other hand, a high income earner with an income of \$180,000 could salary sacrifice \$2,064 (ie $\$1,000/[1 - 38.5\%]$ plus $\$300/[1 - 31.5\%]$).

Taxable income	Current tax withheld (2009-10)*	Tax withheld (2010-11)*	Increased after-tax income	Gross amount to salary sacrifice**
\$50,000	\$9,600	\$9,300	\$300	\$438
\$80,000	\$19,050	\$18,750	\$300	\$438
\$125,000	\$36,825	\$36,075	\$750	\$1,170
\$150,000	\$46,700	\$45,700	\$1,000	\$1,576
\$180,000	\$58,550	\$57,250	\$1,300	\$2,064

* Includes Medicare levy but excludes tax offsets.

** Beware of contribution caps and avoid excessive contributions.

The opportunity also exists for your clients to use the additional contributions to fund insurance premiums (such as salary continuance, life and total and permanent disablement) to establish new cover or undertake a review to increase their existing level of cover.

Medicare levy low-income threshold

Effective from 1 July 2009, the Government will increase the Medicare low-income thresholds from \$17,794 to \$18,488 for individual and \$30,025 to \$31,196 for families. Single pensioners below Age Pension age will increase from \$25,299 to \$27,697.

Medical expense tax offset (METO)

The METO threshold will increase from \$1,500 to \$2,000 from 1 July 2010. The Government will also commence annually indexing the threshold starting from 1 July 2011. The METO currently provides taxpayers with out-of-pocket medical expenses above \$1,500 an uncapped 20 per cent tax offset.

Standard deductions

From 1 July 2012, the Government will provide individual taxpayers with an optional standard tax deduction of \$500 in lieu of claiming work-related expenses increasing to \$1,000 from 1 July 2013. This means an average wage earner will receive a maximum tax return of \$300 per annum.

Comment: This announcement is in-line with the recommendation from the Henry Tax Review.

Non-commercial loan rules

The Government will further refine the non-commercial loan rules announced in last year's Budget. This will clarify the scope of payments that can give rise to a deemed dividend provided to shareholders or their associates. This will be effective from 1 July 2009.

A payment will not arise where a private company provides a dwelling to a shareholder of the private company or their associate, for use as their main residence if the company acquired the dwelling before 1 July 2009 and the private company continues to meet a modified continuity of ownership test.

Comment: This will provide relief for many small business owners that were facing heavier personal tax liabilities.

Interest income

From 1 July 2011, the Government will provide individuals with a 50 per cent tax discount on up to \$1,000 of interest income earned by individuals, including interest earned on deposits held in authorised deposit taking institutions, bonds, debentures and annuity products. The discount will also be available for interest income received via a trust or managed investment scheme.

Comment: This means that for a person earning an average pre-tax interest rate of six per cent, the discount would apply up to a savings balance of just over \$16,500 (assuming no other taxable income). Advisers can add value to their clients by assisting in the ownership structure of the client's interest income earned via utilising husband and wife tax brackets. A family trust structure could provide clients with larger investments in interest bearing investments and further tax minimisation opportunities by utilising the \$1,000 threshold for all family members, including minor children.

Child Care Rebate

The annual cap for the Child Care Rebate per child has increased from \$7,500 to \$7,778 for the 2009/2010 financial year. The Government has elected to cease the indexation of the annual cap for the next four years from 1 July 2010.

Comment: Advisers should speak to their clients about the opportunity to use this rebate to invest for their children's future financial security and education. Clients can become accustomed to paying for the full cost of their children's child care whilst the quarterly payments could be used to invest into growth assets (ie direct shares or managed funds) or a tax efficient insurance bond eg IOOF WealthBuilder.

Changes for non-resident investors

The Government has announced a phase-down in the Interest Withholding Tax (IWT) for non-resident investors will reduce from ten per cent to five per cent. The Government has stated the IWT will reduce the rate to zero when fiscal circumstances allow it at sometime in the future.

The Government has also announced as part of the investment manager regime will be to ensure that non residents investing in foreign assets will not face further Australian tax on their investments when using Australian fund managers.

Comment: The Government has used the Budget to give its in-principle support for nearly all of the 19 recommendations stemming from the Australian Financial Centre Forum's report, *Australia as a Financial Centre: Building on our strengths*. In addition to the above announcements, the Government will introduce the establishment of an online regulatory gateway and the development of an Asia Region Funds Passport.

The formation of a task force made up of senior financial services executives will ensure this continues to be an area of focus for the Government to not only make Australia into an international investment hub whilst also focusing on engaging and enhancing Australia's presence in Asia.

Capital protected product – interest deductions

The new benchmark interest rate for capital protected products from 11 May 2010 will be the Reserve Bank indicator rate for standard variable housing loans plus 100 basis points.

Comment: This is a win for clients as they will receive a higher tax deduction.

Superannuation

Co-contribution

The Government will permanently retain the matching rate for the superannuation co-contribution at 100 per cent with a maximum payment of \$1,000. They will also freeze the indexation applying to the income threshold for the 2010-11 and 2011-12 financial years. Meaning the current thresholds of \$31,920 and \$61,920 will be fixed for the next two years.

Comment: On one hand the Government is providing low income earners with a \$500 superannuation contribution tax rebate, and then on the other hand reducing the maximum co-contribution from \$1,500 to \$1,000 on a permanent basis.

Reduced Input Tax Credit (RITC) for life insurance

The Government has announced it will retain the RITC at 75 per cent for superannuation funds. They have also expanded the list of RITC qualifying items to include acquisitions related to supplies of life insurance by superannuation funds to their members.

Comment: This is good news for the superannuation industry and will also reduce life insurance premiums for members of superannuation funds.

First Home Saver (FHS) Accounts – increased flexibility

The Government has announced that they will amend the FHS Account rules to provide greater flexibility. Currently, an FHS Account holder is required to keep their savings in an FHS account for four financial years before they are able to use those savings to buy a home. If the account holder buys a home prior to the end of that four year period, the balance of their FHS Account must be transferred to their superannuation so that it remains in a concessional tax environment.

The Government will allow these funds to be transferred to an approved mortgage instead of having to be transferred to superannuation.

Minor superannuation measures announced with the Budget

The Government announced a number of minor amendments to superannuation. Rather than break new ground, these measures improve existing rules to make them fairer and more workable. These are:

1. Loss rollover relief for merging funds

The current loss rollover relief is a temporary measure that applies to successor super fund transfers and will cease on 30 June 2011 and originally applied only to situations where an existing fund transferred or merged with another existing fund. The new measure will extend the relief to situations where super funds are transferring into a new fund.

2. Sending in 290-170 tax deduction notices to a successor fund

Where a successor fund transfer occurs, the receiving superannuation fund will now be able to accept s290-170 tax deduction notices and/or a variation notice in respect of personal contributions made to the transferring fund. Currently, this relief only applies until 30 June 2011. This measure will extend the relief permanently.

3. Excess contributions tax

The Australian Taxation Office (ATO) will be given the power to exercise discretion for the purposes of excess contributions tax before an assessment is issued. Currently, the ATO has to wait until after it makes an assessment before it can exercise its discretion to allocate contributions to a different year. For example, a super fund member receives back dated Super Guarantee (SG) contributions on 1 August 2011 for several years amounting to \$20,000 and also makes \$10,000 salary sacrifice contributions for 2011/12. Currently, the ATO would have to wait until after October 2012 to assess the member as having received \$5,000 excess concessional contributions, and wait for the member to apply for the discretion to have \$20,000 of back-dated SG contributions allocated to earlier years. Under the new measure, it appears that the member can apply to the ATO to have the contribution allocated to previous years and no excess assessment needs to happen.

Also, the Government indicated it would clarify the due date for shortfall interest charge for the purposes of excess contributions tax.

Comment: This is a practical but **very limited** measure to improve some of the inefficiencies of the current system of excess contributions tax. Although a welcome efficiency measure in itself, it does not alleviate the unfair application of excess contributions tax, particularly where the caps have been inadvertently breached.

4. Provide new arrangements for public sector defined benefit funds which fund benefits through 'last minute contributions'.
5. All unclaimed superannuation moneys will be paid to the Commonwealth Government, including state and territory public sector super funds. Currently, private sector super funds pay unclaimed moneys to the Commonwealth but not the state or territory government super funds.
6. Tax deductions for superannuation funds extended to include the cost of providing for terminal illness benefits.

Comment: This fixes up an anomaly in the tax law whereby insurance premiums (or self insurance costs) for death and disability are tax deductible to the fund, but technically that part of the premium relating to terminal illness benefits (ie death benefits brought forward) was not deductible even though these benefits can now be paid by a super fund. The deductibility will be back-dated to when terminal illness benefits were approved.

Recommendations previously announced with Henry Report

By 2015, the Government will reduce the company tax from 30 to 28 per cent.

- Small business to benefit from company tax cut to 28 per cent from 2012 and other write-off concessions for small business. This includes an increase to \$5000 of the immediate write-off threshold (up from \$1000).
- Introduction of a 40 per cent Resources Super Profits Tax from July 2012 including a refundable credit to resource entities from state royalties.
- An infrastructure fund to be paid to the states each year to start at \$700 million in 2012.

Superannuation changes:

- A 12 per cent SG – commencing with a 0.25 per cent increase in 2013-14 and 2014-15, followed by 0.5 per cent increments until the SG reaches 12 per cent by 2019-20. The three year lead time recognises that employers and employees need to factor this into future wage negotiations. *Note: The SG rate increase is a Government initiative and not a recommendation of the review.*
- A low income earners government contribution – from 1 July 2012. The Government will provide a contribution of up to \$500 annually into the superannuation account of workers on adjusted taxable incomes of up to \$37,000. This will provide a reward for savings for low income earners by ensuring no tax is paid on SG contributions. The Government will also retain the co-contribution scheme.
- Concessional superannuation contribution caps for those nearing retirement – from 1 July 2012. Workers aged 50 and over with superannuation balances below \$500,000 will be able to make up to \$50,000 in annual, concessional superannuation contributions. This measure is expected to benefit 275,000 people.
- Raising the SG age limit from 70 to 75 – from 1 July 2013. The SG age limit will be raised to 75, which for the first time means workers aged 70 to 74 will be eligible to have SG contributions made on their behalf. Around 33,000 employees are expected to benefit from this measure.

These announcements should provide confidence and a boost to income in retirement for many Australians. The introduction of the ‘catch up concessional contribution cap’ for clients over age 50 with superannuation balances under \$500,000 provides certainty after 1 July 2012, whilst the increase in the SG contribution rate to 12 per cent will make a significant impact to retirement savings especially for younger workers. For older workers seeking to maximise the contributions, they will need to reduce the level of salary sacrifice to accommodate for the continued rise in the SG contribution rate – albeit a reduction in the tax effectiveness of a salary sacrifice strategy.

These announcements are subject to industry consultation before the draft legislation will be available for review. At this stage, superannuation splitting between couples (including same sex and opposite sex couples) will prove effective. This may present a long term opportunity for a client to split their superannuation with their spouse in order to keep their account balance under \$500,000 and to retain access to the catch up concessional contribution cap whilst over age 50.

Other strategies may become relevant such as smoothing of investment returns within self managed superannuation fund or transition to retirement in order to actively manage a client’s account balance to remain within the \$500,000 limit. Clients should consider superannuation splitting at a younger age over a longer period of time.

Even though the Government will increase the age for receiving SG contribution support from age 70 to 75, it is unlikely this will have a significant impact due to this age bracket working reduced hours (ie part-time) and transitioning into retirement.

Health and ageing – aged care

Accommodation bonds

The Government will enhance the protection of accommodation bonds held by aged care providers by applying more stringent requirements on how accommodation bonds can be invested. In addition, criminal penalties for the misuse of accommodation bonds will also be introduced along with enhanced reporting requirements on how bonds are used.

Comment: An accommodation bond can form a large portion of a client’s wealth during their twilight years and their final estate. This announcement will improve transparency and provide confidence to clients when paying an accommodation bond upon entering an aged care facility (ie Hostel and extra care Nursing Home).

Improving arrangements for complaints

The Government will improve complaints handling processes for consumers of aged care services. This increases the funding for the Aged Care Complaints Investigation Scheme to improve its ability to respond to users of aged care services, or their relatives or advocates, who raise concerns or queries about the care received. The Government will also focus on improving access to mediation and conciliation services.

Comment: With the number of people entering into aged care facilities continuing to increase, an improvement in the complaints handling process is a positive step forward. This continued focus on the quality of care and standard of living within the aged care sector should provide ageing Australians with more confidence when making the decision to move into an aged care facility.

Increasing business efficiency

The business efficiency of aged care providers will be improved by establishing a new provider benchmarking system. The new benchmarking system will allow aged care providers to compare their operational and service performance with other providers. This will allow them to identify areas where they can improve their performance.

Comment: Clients entering into an aged care facility will be able to take advantage of this new benchmarking system by having access to the operational and service performance data of each provider. This will enable clients to make an informed choice when entering into an aged care facility.

Social security (including child support)

Special Disability Trusts

Special Disability Trusts enable parents and immediate family members to set aside funds for the future care and accommodation needs of a family member with a severe disability. The trust can form part of a client's retirement planning or their estate plans.

The trust also provides the current advantage of up to \$551,750 (plus the family home) in assets being excluded from the income or assets means tests for Disability Support and Age Pension purposes for the beneficiary.

The Government will provide funding over four years to amend the eligibility criteria and allowable uses for Special Disability Trusts, to make them more accessible and increase its uptake. These changes will also:

- expand the definition of a beneficiary to include people with a disability who can work up to seven hours per week; and
- amend the allowable uses for the trust to include all medical expenses, including membership costs of private health funds, maintenance expenses of Special Disability Trust property and discretionary spending of up to \$10,000 per year.

Comment: The take up of Special Disability Trusts has been quite low due to the tight restrictions surrounding the use of the trust funds for the future care and accommodation needs for the beneficiary with a severe disability. This change should make these trusts more appealing. However, the strict Centrelink compliance requirements and the challenging role as trustee still remain.

Fraud prevention and compliance

To aid against fraud and improve compliance, the Government has announced the following changes to:

- Improve the current process for garnishing tax returns of ex-Centrelink customers who have an outstanding debt with Centrelink and no arrangement in place to repay that debt. The funding will enable the ATO to automatically intercept tax refunds on behalf of Centrelink.
- Assist Centrelink to act on information from government intelligence and law enforcement agencies to identify and prevent abuse of the social welfare system by organised crime groups.
- Develop and implement an enhanced compliance capability to help ensure that parents meet their child support obligations.
- Pilot new ways of preventing fraud and supporting compliance in the social, health and welfare payments system.

Comment: Centrelink and other relevant Government agencies will have an increased amount of information and data about your client's personal circumstances and financial affairs. Like it or not, your clients will come under increased scrutiny into the future.

Find out more

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