

# Special Report

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## The 2010 Federal Budget

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## **1. Overview**

The Rudd Government handed down its third Budget on 11 May 2010 with no great surprises. Many of the changes had already been announced or corrected anomalies in legislation but some new measures were announced.

The Budget introduced some changes for financial planning strategies with:

- Adjustments to superannuation concessions (co-contribution and the new low income contribution)
- Increased superannuation guarantee (SG) payments
- Discount on interest income
- Continuing higher concessional contribution cap for people over age 50 with lower superannuation savings
- Increased flexibility to use Special Disability Trusts, and
- Lower company tax rates.

The funding for many expenditure measures is underpinned by the resource sector 40% profits tax. Therefore some measures may not be introduced unless legislation to introduce this tax is passed.

This paper summarises the main Budget announcements that will impact on financial planning strategies. It should be noted that all measures discussed in this paper (except for the personal tax cuts) are proposals only. Legislation is still required to be passed and further changes could be made. In some areas, further clarification is still required. We could also have an election called before some of the legislation is passed. Most changes have a delayed commencement date.

## **2. Economic implications**

In the Federal Budget the Government focused on demonstrating its credentials in sound economic management. The Treasurer's speech highlighted the success of the Government's fiscal spending measures as a means of shielding the Australian economy from the worst of the global recession. In reality, this success was also due to the Reserve Bank of Australia's aggressiveness in cutting official interest rates.

The Australian economy is forecast to grow by 3.25% in 2010/11 and by 4% in 2011/12. Our unemployment is anticipated to fall further to 4.75% in 2011/12. Higher business confidence and the global recovery, particularly the growth in Asian economies, are expected to contribute to a recovery in business investment and exports. Inflation is expected to remain in check at 2.5%.

One of the Government's key results is the announcement that the Budget is expected to return to surplus by 2012/13 which is three years ahead of schedule and well before any of the major advanced economies.

Our net debt is expected to peak lower and earlier than initially anticipated. As a percentage of GDP, Australia's net debt is expected to peak at 6.1% of GDP in 2011/12 which is significantly lower than other major advanced economies.

Key discussion points relating to the economic implications of the Federal Budget that a financial adviser may include in client discussions are as follows.

- The Federal Budget highlights the success and resilience of the Australian economy and the positive impact it has had on employment during the Global Financial Crisis relative to other major developed economies.
- It is anticipated that the Australian economy will continue to grow strongly in the next financial year and our unemployment rate is expected to decline further.
- The Budget is now expected to return to surplus three years earlier than initially expected largely due to the resilience of our economy. This has been in part due to greater tax receipts from higher company profits and lower Government outlays in areas such as employment benefits.
- Australia's net debt as a share of GDP (i.e. the size of the economy) is expected to be less than one-tenth of the average of the major developed economies.
- The Government will rely on the resource super profits and tobacco taxes to fund many of its spending measures in the Budget. The resource tax is heavily reliant on the movement in commodity prices and therefore the continued growth in developing countries such as China. If these assumptions do not eventuate such as China's demand for our commodities is not as strong as anticipated, then the Government's revenue may fall short of expectations which in turn may impact their ability to support their spending measures.
- The reduction in the company tax rate and announced measures supporting small businesses should be positive for listed shares (perhaps with the exception of resource companies) and small companies. Financial services companies should benefit from the increase in the superannuation guarantee from 9% to 12%.
- The impact of the super resource profit tax may reduce the need for larger increases in official interest rates if as a result of this tax there is a reduction in investment made in resource projects that in turn reduces the capacity utilisation issues facing this sector. This combined with the Government's broader responsible fiscal management may reduce the pressure on higher official interest rates

### **3. Superannuation**

The Budget did not announce significant new changes to superannuation. Most of the changes had already been announced last week in response to the Henry Tax Review but it was disappointing to see effective cuts to the co-contribution.

#### **a) Superannuation Guarantee**

Many reports have identified that the current level of Superannuation Guarantee (SG) is inadequate to achieve adequate retirement savings. It is proposed to increase SG from 9% to 12%. The rate will be increased gradually from 1 July 2013 to 1 July 2019 as shown in the table below.

Financial year	Rate	Increase
2013/14	9.25%	0.25%
2014/15	9.5%	0.25%
2015/16	10%	0.5%
2016/17	10.5%	0.5%
2017/18	11%	0.5%
2018/19	11.5%	0.5%
2019/20	12%	0.5%

SG is currently payable for most employees up to age 70. From 1 July 2013 SG is proposed to be payable up to age 75 in line with the contribution age limit. This will increase retirement savings for older workers and provide some consistency in rules.

**Client implications:**

If this proposal is passed the implications for clients will include:

- If SG contributions continue to be assessed against the concessional contribution caps the higher SG levels will reduce the amount available for salary sacrifice or personal deductible contributions.
- Cash salary may potentially reduce depending on arrangements for the salary package. Some employment contracts specify a total employment package and SG is deducted from this amount. If this package total is not increased to cover the higher SG it may reduce the cash salary component. For example, Jane’s package is \$109,000 consisting of \$100,000 salary and \$9,000 SG. If the rate of SG increases to 9.25% and the employer continues to pay a total of \$109,000. Jane now receives \$99,771 salary and \$9,229 SG.
- Employers will need to factor in the additional employment cost into expense budgets.

**b) Contribution for low income earners**

The Government will provide an annual superannuation contribution up to \$500 for individuals with adjusted taxable income of \$37,000 or less, calculated as:

$$\text{Government contribution} = \text{concessional contributions} \times 15\%$$

The contribution is limited to a maximum of \$500 (not indexed). This measure effectively refunds the contributions tax on the first \$3,333 of concessional contributions for low-income earners.

<b>Example</b>	Roy has adjusted taxable income of \$26,000. His employer pays SG contributions during the financial year of \$2,340. Roy will receive a superannuation contribution directly to his account from the Government of \$351 (ie. \$2,340 x 15%).
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This measure aims to provide some equity in superannuation concessions for low-income earners. However, for many people superannuation savings may not increase as the gain under this measure may be offset by the reduction in the future co-contribution (see details in section c below).

The superannuation contribution only applies to concessional contributions including SG, salary sacrifice, employer voluntary contributions and personal tax deductible contributions.

This proposal is effective from 1 July 2012.

**Client implications:**

If this proposal is passed the implications for clients with income under \$37,000 will include:

- Increased incentive to make personal deductible contributions, if eligible, or
- Employees may have an incentive to salary sacrifice but after-tax contributions to access the co-contribution should be considered first.

**c) Co-contribution misses out on increases**

Cuts to the co-contribution in last year’s Budget were announced as temporary cuts but they are now proposed to be permanent. The measures announced in this Budget are:

- The co-contribution matching rate will be permanently set at 100%, and
- The maximum co-contribution payable will remain at \$1,000.

The Government will also freeze the income threshold for two years. The lower threshold will stay at \$31,920 and the cut-out threshold at \$61,920 until 1 July 2012.

**Client implications:**

These cuts will reduce the number of people who are eligible for the co-contribution and rescind the promised future increases. The changes may also offset the benefit from the new low income contribution so that low income earners who make personal after-tax contributions may in fact, not be any better off.

<b>Example</b>	<p>Claire has adjusted taxable income of \$37,000. Her employer makes SG contributions of \$3,330 on her behalf.</p> <p>Using the current thresholds she can make an \$830 non-concessional contribution and receive an \$830 co-contribution. If the low income contribution was effective she would also receive a \$500 contribution into her fund from the government. This is total net contributions (including SG) of \$4,990 into her fund.</p> <p>If the co-contribution had been allowed to increase back up to \$1,500 at a 150% matching rate (and no low income contribution), Claire would have been able to contribute her \$830 non-concessional contribution and receive a \$1,245 co-contribution. This is a total net contribution (including SG) of \$4,905 into her fund.</p>
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**d) Catch-up contributions for over-50s**

The transitional \$50,000 concessional contribution cap currently ends on 1 July 2012. From that date the standard cap of \$25,000 will apply. The Government proposes to continue the concessional cap of \$50,000 as a permanent measure from 1 July 2012 for individuals aged 50 and over but only if the individual’s total superannuation savings are less than \$500,000.

This measure is designed to assist those with low superannuation balances to make additional 'catch-up' contributions from age 50.

The superannuation industry will be consulted on how to administer the \$500,000 threshold.

**Client implications:**

If this proposal is passed the implication for clients will include:

- Clients age 50 and over may be able to increase salary sacrifice contributions or personal deductible contributions, if eligible.

**e) Deduction for terminal illness benefits - SMSFs**

Complying superannuation funds are able to claim tax deductions for the amount paid as a death or total and permanent disability benefit if the person terminated employment due to the death or disability. These deductions can only be claimed if the trustee elects not to claim a tax deduction for the insurance premiums in the current and future financial years. This is available to all superannuation funds but is usually only claimed by self-managed superannuation funds.

The legislation is proposed to be extended so that the deduction can also be claimed if benefits are paid due to a terminal medical illness. This corrects an anomaly in the legislation.

<b>Example</b>	<p>Alfonso has a life insurance policy in his SMSF for \$1million. He has been diagnosed with a terminal illness which caused him to stop working. The insurance claim is paid into his superannuation fund and then released to him. His \$200,000 savings are also released.</p> <p>In the same financial year, the SMSF trustee paid an insurance premium of \$3,800.</p> <p>Alfonso is age 45 and has an eligible service period of 10 years. The trustee can choose to claim a tax deduction for the \$3,800 premium or the future service portion of the payout, ie \$800,000 (\$1.2million x 20/30).</p> <p>By claiming the \$800,000 tax deduction the SMSF receives tax savings of \$120,000. Any unused deduction can be carried forward to future years. The trustee will not be able to claim tax deductions for insurance premiums on the life of any members in future years.</p>
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**f) ATO discretion for excess contributions**

The ATO will be given greater discretion before issuing an excess contribution assessment. This may provide scope to avoid an excess contribution but further details need to be released to determine in what circumstances this discretion will operate.

## 4. Taxation

### a) Personal tax rates

Legislation has already been passed to implement tax cuts from 1 July 2010. These tax cuts were restated in the Budget. The personal tax rates for 2010/11 are:

Taxable Income	Tax rate
\$0 - \$6,000	Nil
\$6,001 - \$37,000	Nil + 15% for each \$1 over \$6,000
\$37,001 - \$80,000	\$4,650 + 30% for each \$1 over \$37,000
\$80,001 - \$180,000	\$17,550 + 37% for each \$1 over \$80,000
\$180,001 +	\$55,550 + 45% for each \$1 over \$180,000

In addition, the low income tax offset increases to \$1,500. This effectively allows an individual to earn \$16,000 before tax is payable.

#### Client implications:

With lower tax rates next year look for opportunities to defer income until after 1 July but claim deductions before 1 July. This may include prepayment of expenses to increase deductions this year.

### b) Senior Australian Tax Offset

The senior Australian tax offset will increase for 2010/11 to:

- Single person - \$30,685
- Member of couple - \$26,680

It is also proposed to amend the calculations from 1 July 2010 to allow for the reduction in low income tax offset once the person's income exceeds \$30,000.

#### Client implications:

The recalculation will mean some clients may receive a lower entitlement to SATO and pay more tax than in previous years.

### c) Low income Medicare thresholds

Medicare is payable if taxable income exceeds thresholds announced in each year's Budget. The table below shows the 2009/10 thresholds.

	No Medicare if taxable income is equal to or less than
Individuals	\$18,488
Individuals receiving a pension and under age pension age	\$27,697
Couple (combined)	\$31,196
Additional for each dependent child/student	\$2,865

#### **d) Medical expenses tax offset**

The medical expenses tax offset threshold will increase from \$1,500 to \$2,000. Currently a person is able to claim a 20% tax offset for medical expenses over \$1,500. By increasing the threshold to \$2,000 a taxpayer will incur a higher level of medical expenses before receiving a tax concession.

The threshold will increase from 1 July 2010 and will be indexed each year by CPI.

#### **e) Simplification of tax returns**

When preparing tax returns, individuals will be able to choose to claim a standard deduction of \$500 for work-related expenses and the cost of managing tax affairs for the 2012/13 financial year. This amount would increase to \$1,000 for the 2013/14 and later financial years.

Alternatively the person can choose to keep records and claim actual expenses if this amount will be higher.

##### **Client implications:**

The standard deduction may simplify the completion of tax returns. For people with minimal tax deductions it may increase the amount of deductions and reduce tax payable. This can also flow onto increased benefits that are linked to taxable income.

#### **f) Child care rebate**

The child care rebate will be reduced from \$7,778 to \$7,500. The rebate will not be indexed and will remain at \$7,500 for four years from 1 July 2010.

Families will still be eligible to claim 50% of out-of-pocket expenses up to the annual cap, however the cap will be lower so the amount claimed will be lower.

##### **Client implications:**

Families who previously claimed the maximum rebate will receive a reduced amount starting from the 2010/11 financial year.

#### **g) Non-commercial loan rules**

In last year's Budget, rules were changed so that non-commercial loan rules from a private company to a shareholder or associate may be taxed as a dividend from 1 July 2009.

This measure has been amended to clarify that where a private company provides a home to a shareholder or their associate, this is not deemed to be a dividend.

## 5. Investments

### a) 50% discount on interest income

Individuals will receive a 50% discount on the first \$1,000 of interest income from 1 July 2011. This means only half of the first \$1,000 interest will be included in the person's taxable income.

Interest income may be derived from authorised deposit taking institutions (eg banks, credit unions), bonds, debentures and annuity products. Interest may be earned directly or through a trust or managed investment scheme.

The Government has indicated that the discount amount will be excluded from adjusted taxable income. This may mean some taxpayers will receive a higher entitlement to certain benefits and concessions, such as tax offsets.

#### Client implications:

This change may make interest income more attractive for investors.

<b>Example</b>	<p>Troy compares investing \$10,000 into Australian shares and a term deposit. The term deposit pays 5.5% per annum and the shares pay a fully franked dividend of 3% per annum and capital gains of 6% per annum. Troy is on the 31.5% marginal tax rate (including Medicare).</p> <p>Assuming all tax is paid from the investment balance over a 10 year period the net account balance for each option at the end of the 10 years is:</p> <ul style="list-style-type: none"> <li>• Term deposit (without 50% discount) - \$14,475</li> <li>• Term deposit (with 50% discount) - \$15,730</li> <li>• Shares (sold at 10 years and net of CGT) - \$22,130</li> </ul> <div style="text-align: center;"> </div> <p>The higher returns on shares still produce a better result, but the relative difference between the shares and term deposit has reduced with the 50% discount.</p>
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## **b) Capital Protected Loans**

Investors can currently only claim a tax deduction for interest on capital protected loans up to the Reserve Bank of Australia (RBA) indicator rate for standard variable housing loans (7.15% in April 2010) if the loan was entered into after 13 May 2008. The undeducted amount is added to the cost base to reduce the taxable capital gain.

The deductible amount will be increased to the standard variable housing loan rate plus 100 basis points. This may allow a higher tax deduction for investors.

Capital protected loans entered into before 14 May 2008 have been able to claim a deduction equal to the unsecured personal loan rate (14.75% in April 2010) until 13 May 2013. This rate will now continue to apply until 30 June 2013.

## **c) First Home Saver Accounts (FHSA)**

Under current rules the money in the FHSA cannot be used to buy a house unless it has been invested in the FHSA for at least four years. If a house is purchased before this time, the money must be transferred into superannuation to maintain the concessional treatment.

The rules are proposed to be amended to allow the money to be paid into a mortgage provided it has been invested in the FHSA for a minimum period. Consultation will be held with industry to determine how to apply these changes.

### **Client implications:**

This measure may make FHSAs a more attractive savings option.

## **d) Instalment warrants and CGT**

The Government had previously announced legislation would be introduced to ensure CGT is not payable under an instalment warrant arrangement when the second instalment is made. CGT will only be payable when the asset is sold.

Under an instalment warrant arrangement the asset is held in trust until the second instalment is made to repay the loan in full. Legal title is then transferred to the investor. It has been an industry concern that incorrectly established instalment warrant arrangements may give rise to CGT on payment of the second instalment.

The Government has proposed amendments to legislation to treat the investor as the beneficial owner of the asset from initial purchase so that CGT is not triggered upon transfer of legal title. This also applies to superannuation funds.

## 6. Company taxation

Three changes impacting company taxation were announced in the Government's response to the Henry Tax Review. These have been restated in this Budget. The changes are summarised below.

### a) Lower company tax rate

The company tax rate will be reduced from 30% as follows:

Financial year	Rate
2013/14	29%
2014/15	28%

The reduction is partly to encourage investment in Australia.

Note: The lower rate of 28% will apply to small businesses from 2012/13.

#### Client implications:

This may increase the profitability of activities conducted through a private company and may encourage clients to maintain earnings in the company structure.

### b) Initiatives for small businesses

The Government has announced a range of proposals to reduce red tape and complexity for small businesses.

#### Lower company tax rate

Small businesses will access the lower company tax rate of 28% earlier than large businesses with the start date from the 2012/13 financial year.

#### Depreciation measures

From 2012/13 the low value asset threshold will increase from \$1,000 to \$5,000. This is the amount that can be immediately written off by the small business. This provides an immediate deduction and simpler accounting.

Small businesses will be allowed to have a single depreciation pool (excluding buildings) with a write-off rate of 30%. This reduces complexity as the business is no longer required to monitor different depreciation pools. This measure commences from 2012/13 however consultation will occur during 2010/11.

#### Drought assistance

The Government will provide \$25.3 million over two years to continue support for small businesses with up to 100 employees that are dependent on business from farmers in regions declared eligible for Exceptional Circumstances assistance.

The small business assistance provides interest rate subsidies and income support. Eligible recipients are also provided with a health care concession card and access to Youth Allowance for their children.

The non-business salaries and wages exemption of \$20,000 per annum and the non-business assets exemption of \$750,000 will remain.

## **7. Social security and aged care**

### **a) Aged care places**

The Government announced measures to increase the number of places in aged care. One of these measures was to reduce the number of high-care residential places and increase the number of at-home places. The overall target is still to provide 113 operational places per 1,000 people age 70 or older by 2011.

Significant changes have not been made to funding or processes as the Government is waiting for the outcome of a recently announced Productivity Commission Inquiry into aged care.

### **b) Protecting accommodation bonds**

The aged care sector is currently holding over \$7billion in accommodation bonds. These bonds are guaranteed by the Government. The Government intends to apply more stringent requirements on how bonds can be invested and apply criminal penalties for the misuse of bonds.

The Government will consult with consumers and industry with a view to putting the new arrangements in place by 1 July 2011.

### **c) War widows/ers in de-facto relationships**

War widows/ers who marry after the death of a veteran partner cannot continue to claim the war widow/er pension. However, an anomaly has existed to allow those entering into a de-facto relationship to receive the pension. This anomaly will be corrected so that:

- War widows/ers who remarry or enter a de-facto relationship before claiming the pension will not qualify
- War widows/ers who remarry or enter a de-facto relationship after claiming the pension will continue to receive the pension.

### **d) Extend accessibility to Special Disability Trusts**

The Government will expand the definition of a beneficiary of a Special Disability Trust to include disabled individuals who are able to work up to seven hours per week (excluding work in an Australian Disability Enterprise). This measure is designed to extend the opportunity for families to utilise a Special Disability Trust for a relative.

The range of allowable uses for the trust will be increased to include all medical expenses, maintenance expenses of Special Disability Trust property and discretionary spending up to \$10,000 per year.

This measure is proposed to commence from 1 July 2010.

**Client implications:**

Clients with disabled family members may wish to reconsider the opportunity to use a Special Disability Trust. Special Disability Trusts provide an effective estate planning strategy for some clients. It provides favourable social security treatment for the beneficiary up to a specified threshold and allows family members to gift, within limits.

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