

2010-2011 Federal Budget Report

There were not too many surprises in this years Federal Budget with the Treasurer, Wayne Swan, delivering what he described as a 'no frills responsible' budget. There were a couple of sweeteners such as the 50% discount for interest income and a standard tax deduction for work related expenses, but many of the measures that impact on financial planning just reconfirmed the Governments response to the Henry review.

A closer look at the budget papers delivered a few unexpected blows including a permanent reduction in the maximum co-contribution and matching rate.

It appears we will have to wait longer to hear more about the Governments view on the large number of Henry review recommendations still to be addressed. This report, as always, focuses on the impact on financial planning strategies.

Savings measure

50% discount for interest income

From 1 July 2011, individuals will be entitled to a 50% tax discount on up to \$1,000 of interest earned, including interest on deposits held with banks, building societies or credit unions, as well as bonds, debentures or annuity products. The discount will be available for interest income earned directly as well as indirectly, such as via a trust or managed investment scheme.

If for example, a person is earning an average pre-tax interest rate of 6%, the discount would apply up to a savings balance of around \$16,700.

Currently, there is a large variation in the tax treatment of alternative savings vehicles. Most interest income is taxed at the individual's marginal rate, while capital gains for example can receive a 50% discount. The introduction of this new discount will remove this distortion and deliver a better taxation regime for savings.

The Government will consult on details concerning the operation of the discount, including on the final scope of eligible savings products.

Comment:

This measure will be very welcomed, particularly by many older Australians who prefer holding their non-superannuation savings in interest-bearing products. The inclusion of annuities in the range of products covered by the savings tax discount is applauded by Challenger, and further indicates the Governments recognition of annuities as a mainstream vehicle for providing guaranteed income.

Superannuation measures

Permanent reduction to the superannuation co-contribution matching rate and maximum payable and pause to the indexation of the income threshold for two years

The matching rate for the superannuation co-contribution will be permanently retained at 100% of a person's eligible personal non-concessional superannuation contributions up to a maximum contribution of \$1,000.

The Government will also freeze the indexation applied on the income threshold above which the maximum superannuation co-contribution begins to phase down for 2010/11 and 2011/12. This means that the thresholds will be frozen at \$31,920 and \$61,920 for the next two years.

Comments:

This unexpected measure is not great news for lower to medium income earners. The co-contribution matching rate was set to increase to 125% for 2012/13 and 2013/14 financial years, with a maximum co-contribution of \$1,250. From 2014/15, it was to return to the previous matching rate of 150%, with a maximum co-contribution of \$1,500.

Increasing the superannuation guarantee (SG) rate to 12%

The SG rate will be increased gradually from its current rate of 9% with initial increments of 0.25% on 1 July 2013 and on 1 July 2014. Further increments of 0.5% will apply annually up to 2019/20, when the SG rate will be set at 12 per cent as outlined in the table below.

Financial year	SG rate (%)
2009/13	9%
2013/14	9.25%
2014/15	9.5%
2015/16	10%
2016/17	10.5%
2017/18	11%
2018/19	11.5%
2019/20	12%

Comments:

This will be a welcome boost to the retirement savings of most working clients. Salary sacrifice arrangements and concessional contribution strategies will need to be reviewed in light of the increases to ensure the concessional contribution caps are not breached. It will be interesting to see how salary packages are impacted over the coming years. Employees may need to prepare for a drop in take-home pay as salary packages are merely adjusted to include a higher proportion of super.

The SG age limit to increase from 70 to 75

This proposal raises the superannuation guarantee (SG) age limit from 70 to 75 commencing 1 July 2013. Currently SG only applies to people aged up to 70.

Comments:

Whilst this measure will only affect a small number of clients, it simplifies the contribution rules as the new SG age limit will now match the age limit for voluntary and self employed contributions. Spouse contributions continue to be limited up to age 70.

It will be interesting to see whether in the future the Government will consider a recommendation from the Henry review to remove the restriction on people aged 75 and over making contributions to super. The recommendation involves maintaining the work test for those aged 65 and over.

Government super contributions tax rebate for low income earners

The Government will make a super contribution of up to 15% of the concessional contributions made by or for individuals on adjusted taxable incomes (ATI) of up to \$37,000 (not indexed), subject to a maximum limit of \$500 (not indexed). This will apply from 1 July 2012 and paid into the person's super account in the 2013/14 financial year.

This means that clients with ATI's of \$37,000 or less, in effect, will not pay contributions tax on concessional contributions. Take for example a client on ATI of \$35,000. The 9% SG payable on this amount is \$3,150 and will currently result in a net contribution of \$2,677.50 in the super fund. Under this measure, the client's super fund would receive a Government contribution of \$472.50 in the following financial year increasing the contribution amount to \$3,150.

The Government will consult on details of the changes.

Comments:

This measure may encourage some clients on lower incomes to salary sacrifice more to super to take advantage of the maximum limit. Self employed clients that meet the 10% test and those not working but who have investment income, may also take advantage of the measure by making concessional contributions if their ATI is less than \$37,000.

Concessional contributions (CC) cap increase

The CC cap for those aged 50 or more was set to reduce to \$25,000 from 1 July 2012. This measure retains the higher CC cap of \$50,000 (indexed) permanently, but only for those who have total super balances of under \$500,000.

Financial year	Current CC cap	Proposed CC cap
2009/10 to 2011/12	\$50,000	N/A
From 1 July 2012	\$25,000	\$50,000 (if super balance under \$500,000)

The Government will consult with the super industry on the operation of the \$500,000 threshold.

Comments:

This measure will greatly assist those clients employing salary sacrifice and transition to retirement strategies (TTR) at a time when they are better placed to contribute more to super. Great care will need to be taken for clients with balances close to \$500,000 and contribution splitting strategies may assist here. It will be interesting to see how the Government will view recontribution strategies used to reduce super balances.

They will presumably use reporting systems currently in place for member contribution reporting to manage excess contributions though this does not currently capture pension balances. There will be several factors to consider during the consultation period including what date the \$500,000 threshold applies and how to value defined benefit interests.

Deductibility to funds of cost of providing terminal medical condition benefits

The range of benefits that are deductible by complying super funds and retirement savings account (RSA) providers will be extended to include terminal medical condition (TMC) benefits. This measure has retrospective effect from 16 February 2008, the date the TMC condition of release was introduced into the super legislation.

Comment:

This measure will bring TMC benefits in line with those applying to death, permanent and temporary incapacity benefits.

Other super minor benefits

A number of minor amendments to improve the operation of the super legislation will be made with effect from the 2010/11 income year.

The amendments include:

- Allowing the Commissioner of Taxation to exercise discretion for the purposes of excess contributions tax before an assessment is issued;
- Clarifying the due date for the shortfall interest charge for purpose of excess contributions tax;
- Increasing the time limit for deductible employer contributions made for former employees;
- Permanently allowing a claim for a deduction for eligible contributions to be made to successor super funds;
- Providing new arrangements for public sector defined benefit schemes which fund benefits through last minute contributions.

Comment:

Whilst there is no relief from the current excess contributions tax regime as industry has been calling for, the ability for the Commissioner to exercise discretion before an assessment is issued is welcomed as it will provide certainty to clients regarding their assessment at an earlier time.

Taxation measures

Personal Income Tax – increase in the medical expenses tax offset claim threshold

The threshold above which a taxpayer may claim the net medical expenses tax offset (NMETO) is to increase from \$1,500 to \$2,000 from 1 July 2010, and is then to be indexed to CPI from 1 July 2011.

The NMETO currently allows taxpayers to receive a tax offset equal to 20% of net unreimbursed eligible medical expenses above \$1,500. This measure reduces the potential offset by up to \$100.

Comment:

This is a blow to taxpayers who have substantial medical expenses throughout the year. However it is worth noting that the threshold had not been increased since 2002-03. Note that for Aged Care residents, the daily care fees, income tested fees, bond annual retention amount, accommodation charge and periodic accommodation payments are all eligible net medical expenses.

Personal Income Tax – Increasing the Medicare levy low-income thresholds

The Medicare low-income thresholds will increase to \$18,488 for individuals and \$31,196 for families effective 1 July 2009. The additional amount of threshold for each dependent child or student will also increase to \$2,865.

The Medicare levy threshold for single pensioners below Age Pension age will increase to \$27,697 effective 1 July 2009. This ensures that pensioners below Age Pension age do not pay the Medicare levy when they do not have an income tax liability.

Standard Tax Deduction for Work-Related Expenses and Tax Accounting Costs

The Government proposes to allow a standard deduction of \$500 for work-related expenses and the cost of managing tax affairs from 1 July 2012. From 1 July 2013 the standard deduction will increase to \$1,000.

Those with deductible expenses greater than the standard deduction amount will still be able to claim their higher expenses in the usual way.

Comment:

This will be an appealing option for those who are employed on a salary with little to claim. Those with investments are likely to continue to claim actual expenses.

Capital protected borrowings – change in benchmark interest rate

Those around for Wayne Swan's first Federal Budget in 2008 will remember the unpopular measure reducing the deductible interest on a capital protected borrowing arrangement from the Reserve Bank's 'indicator variable rate' for personal unsecured loans to the Reserve Bank's indicator variable rate for standard housing loans – a lower rate, and therefore a lower deduction. The measure was effective from 7.30pm, 13 May 2008 (the night of the announcement).

The Government has announced it will adjust the benchmark interest rate that applies to capital protected borrowings to the RBA indicator rate for standard variable housing loans PLUS 100 basis points. This is to apply to capital protected borrowings entered into from 7.30pm, 13 May 2008.

They will also extend the transitional arrangements for capital protected borrowings entered into, at or before 7.30pm (AEST) from the announced 13 May 2013 to 30 June 2013 in order to reduce compliance costs for affected taxpayers in the 2012-13 income year.

Income Tax Treatment of Instalment Warrants

The Government seeks to provide certainty for investors in qualifying instalment warrants by treating them as the owner of the underlying asset for income tax purposes, with effect from 1 July 2007.

This measure will also ensure that the opportunity for non-recourse borrowing by trustees of superannuation funds permitted under prudential regulations is not undermined by its tax treatment.

Child Care Rebate – return the annual cap of \$7,500 and pause indexation

Currently the annual Child Care Rebate (CCR) is capped at \$7,778 per child and is indexed each year. The Government will reduce the maximum CCR claimable per child to \$7,500 and pause indexing for four years from 1 July 2010.

Lowering the company tax rate with an early start for small business

The company tax rate will be reduced from 30% to 29% from 1 July 2013 and to 28% from 1 July 2014. There will be an earlier start for eligible small business with a reduction in the company tax rate to 28% from 1 July 2012. This means that small business companies will have a lower tax rate than other companies until 1 July 2014.

The change is expected to make Australia's company tax rate more competitive relative to other similar sized OECD countries and make Australia a more attractive destination for foreign investment.

Comment:

Clients running businesses as sole traders or via trust or partnership structures may question whether to incorporate. Consideration must be given to factors such as the various capital gains tax concessions not available to companies, and SG requirements for example.

Small business instant write off

Effective 1 July 2012, this proposal will allow small businesses to immediately write off assets valued at under \$5,000 (up from \$1,000) currently and to write off all other assets (except buildings) in a single depreciation pool at a rate of 30%. Currently, small businesses allocate assets to two different depreciation pools.

Resource super profits tax

A Resource Super Profits Tax (RSPT) will be introduced on 1 July 2012 at a rate of 40% on profits made from the exploitation of Australia's non renewable resources. The RSPT is a key part of the Government's reform agenda as the delivery of the other measures such as lowering company tax rates and the various superannuation measures are contingent on the implementation this measure.

Welfare

Aged Care – protecting accommodation bonds

There were a number of Aged Care measures, however they were applicable to the Aged Care providers, and therefore not relevant to this report. One item of interest to financial planners, however, was that 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 the bonds will be introduced.

Reporting requirements in relation to how bonds are used will also be strengthened. The Government will consult with consumers and industry with a view to putting the new arrangements in place by 1 July 2011.

Comment:

The Government recently asked the Productivity Commission to undertake a public enquiry into Australia's aged care system to develop detailed options for further structured reform. The release of the draft report is not expected until December 2010 with a final report due in April 2011.

Job Capacity Assessment – assessments for Disability Support Pension (DSP) and employment services

From 1 July 2010, job seekers who seek a temporary exemption from participation requirements due to a medical condition will have the exemption determined by Centrelink staff rather than a Job Capacity Assessment.

From 1 July 2011, job seekers who need to have their work capacity assessed will undergo a revised assessment of their need for employment services, which will be conducted by an allied health professional.

From 1 January 2012, DSP claimants without sufficient evidence of a future work capacity of less than 15 hours per week may be referred to an alternative income support payment and offered employment assistance through Job Services Australia or Disability Employment Services.

Productive Ageing Package

Announced on 1 February 2010, the Government will provide funding of \$43.2 million over five years to help mature age Australians remain engaged in the labour market.

The measure includes initiatives to support mature age workers in select industries and locations to retrain and move to a new career, or to undertake appropriate training to transition to a supervisory or training role. A consultative forum will be established to provide advice to the Government on initiatives that could lead to the higher participation of mature age workers in employment.

Paid Parental Leave – implementation

In last years Federal Budget, the Government announced its Paid Parental Leave scheme which provides 18 weeks of leave at the level of the national minimum wage to eligible new mothers from 1 January 2011.

The Government will provide funding (\$21.2 million over five years) for the implementation of the scheme. The measure aims to ensure employers and employees can access their rights, gain their entitlements and meet their responsibilities under the scheme.

Special Disability Trusts – greater accessibility

Special Disability Trusts enable parents and immediate family members to put money aside for the future care and accommodation costs of a family member with a severe disability. Furthermore, up to \$551,750 (indexed annually) and the family home can be kept in the trust without being counted under pension income or assets tests for the beneficiary of the trust.

The Government will expand the definition of a beneficiary to include people with a disability who can work up to seven hours per week. In addition, this measure will 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.

War Widow/er pension – claimants who enter a de facto relationship

There is an anomaly which currently exists which allows widow/ers who have entered into a de facto relationship following the death of the veteran partner to claim War Widow/ers Pension entitlements, while those who have since married cannot.

The Government will remove eligibility for the War Widow/ers Pension for people who, before applying, enter a de facto relationship following the death of their veteran partner. By removing this inconsistency, neither war widow/ers who enter a de facto relationship nor those who marry following the death of their veteran spouse, before applying for the pension, will be eligible.

War widow/ers who remarry or enter a de facto relationship after claiming a war widow/ers pension will not lose their entitlement under this measure.

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