FIRSTTECH

FEDERAL BUDGET BRIEFING

4 May 2016

FirstTech Winner of
Best Technical Support
in the Wealth Insights Fund
Manager Service and Platform
Service Surveys for 2016

WEALTH INSIGHTS

Contents

Introduction

Last night the Federal Government handed down the Budget for the 2016-17 year that includes some of the biggest changes to the superannuation system since 1 July 2007.

Some of the major announcements include:

- changes to contributions caps, including the introduction of a lifetime non-concessional cap
- limits to how much can be transferred into pension phase
- removal of work tests for contributions between age 65 and 74
- extending eligibility to claim deductions for personal contributions
- restricting tax-concessions associated with transition-to-retirement pensions.

The Budget also included a number of changes to company tax rates and concessions.

Finally, it is important to note that the Budget announcements are still only proposals at this stage and will depend on the outcome of the upcoming election and on the proposals being legislated.

Superannuation

Concessional contribution cap reduced to $25,000

Effective 1 July 2017

The concessional contributions cap will reduce to $25,000 per annum for everyone regardless of age from 1 July 2017. Currently the concessional contributions cap is $30,000 for clients under age 50 and $35,000 for ages 50 and over.

From 1 July 2017, the Government will include notional (estimated) and actual employer contributions in the concessional contributions cap for members of unfunded defined benefit schemes and constitutionally protected funds.

For individuals who were members of a funded defined benefit scheme as at 12 May 2009, the existing grandfathering arrangements will continue.

FirstTech Comment

The reduced concessional contributions cap of $25,000 does not apply until 2017-18. Clients should consider taking advantage of the current higher concessional cap of $30,000 (under age 50) and $35,000 (age 50 and over) in the 2015-16 and 2016-17 financial years.

Clients should review salary sacrifice arrangements and personal deductible super contributions to ensure they comply with the reduced concessional cap.

Clients may need to drip-feed contributions over a longer period in order to meet retirement goals as a result of the reduced concessional cap.

The ability to salary sacrifice will be restricted as superannuation guarantee may take up a large portion of the concessional cap from 1 July 2017. The inclusion of notional and actual employer contributions in the concessional contribution cap for members of unfunded defined benefit schemes and constitutionally protected funds (CPF) will remove a significant tax advantage for these individuals. Currently contributions made to a CPF are exempt from the concessional cap. CPFs are untaxed super funds that do not pay income tax on contributions or earnings they receive.

Catch-up concessional contributions

Effective 1 July 2017

Unused concessional contribution cap amounts will be able to be carried forward on a rolling basis over 5 consecutive years. This applies to unused cap amounts from 1 July 2017.

Access to unused cap amounts will be limited to individuals with a superannuation balance less than $500,000.

The Government states this measure will allow those who take breaks from the workforce the opportunity to 'catch-up' if they have the capacity and choose to do so.

The measure will also apply to members of defined benefit schemes.

FirstTech Comment

The ability to carry forward unused concessional cap amounts appears to apply to everyone who has contributed less than the concessional cap, not just those who take breaks from the workforce such as women and carers.

However the reduction in the concessional cap to $25,000 pa will reduce the amount of concessional cap available to be carried forward.

Finally, it is unclear how the $500,000 threshold will be calculated and whether it will include previous withdrawals.

Lifetime cap for non-concessional contributions

Effective 7.30pm (AEST) 3 May 2016

A lifetime non-concessional contributions cap of $500,000 will be introduced effective Budget night, 7.30 pm (AEST) on 3 May 2016.

The $500,000 lifetime cap will take into account all non-concessional contributions made on or after 1 July 2007. Contributions made before commencement (ie 7.30 pm AEST on 3 May 2016) cannot result in an excess of the lifetime cap, however those who have exceeded the cap prior to commencement will be taken to have used up their lifetime cap.

Non-concessional contributions made after Budget night that exceed the cap (taking into account all non-concessional contributions since 1 July 2007) will need to be removed or be subject to the current penalty tax arrangements.

The lifetime non-concessional cap will replace the existing annual non-concessional contributions cap of up to $180,000 per year (or $540,000 every 3-years under the bring-forward rule for individuals aged under 65). Those aged 65 to 74 who are currently limited to $180,000 per year will have access to the $500,000 cap without having to meet a work test.

Non-concessional contributions made into defined benefit accounts and constitutionally protected funds will be included in an individual's lifetime non-concessional cap. If a member of a defined benefit fund exceeds their lifetime cap, ongoing contributions to the defined benefit account can continue but the member will be required to remove, on an annual basis, an equivalent amount (including proxy earnings) from any accumulation account they hold.

The lifetime cap will be indexed in $50,000 increments in line with AWOTE.

FirstTech Comment

To determine how much of the lifetime non-concessional cap has been utilised with prior non-concessional contributions, clients will need to add their non-concessional contributions since 1 July 2007 from all funds to determine how much counts towards their lifetime non-concessional cap.

While the Government states the ATO has reliable contribution records since 1 July 2007, it is not clear whether clients will be able to access this information. Clients may need to contact the relevant superannuation funds.

Clients who have previously utilised the bring-forward provisions will need to carefully review their situation to determine whether they have exhausted their lifetime cap.

Prior to recommending a non-concessional contribution, advisers should ascertain the amount of lifetime non-concessional cap that a client has available.

The introduction of the lifetime non-concessional cap may limit the ability to implement a re-contribution strategy. Strategies such as spouse contributions which count against the spouse's lifetime non-concessional cap may assist.

Advisers may wish to refrain from providing advice to make non-concessional contributions until the amount of a client's of non-concessional contributions made since 1 July 2007 can be verified.

Remove contribution eligibility requirements for those aged 65 to 74

Effective 1 July 2017

The current work test that applies for people making voluntary contributions between age 65 and 74 will be removed. This change will allow individuals to make contributions for a spouse aged under 75 without requiring the spouse to satisfy a work test.

The Government says this will simplify the superannuation system for older Australians and allow them to increase their retirement savings, especially from sources that may not have been available to them before retirement, including downsizing their home.

FirstTech comment

Clients are currently required to work 40 hours within 30 consecutive days in the financial year they make a contribution over the age of 65. This proposal will remove this requirement and make it easier for older clients to contribute to super.

When combined with the life-time non-concessional cap this proposal could allow non-working clients aged between 65 and 74 who were previously ineligible to contribute to make non-concessional contributions of up to $500,000 after 1 July 2017.

Introduce a $1.6 million superannuation transfer balance cap

Effective 1 July 2017

A transfer balance cap will be introduced to restrict the total amount of superannuation that can be transferred from accumulation to pension phase to $1.6 million. Where an individual accumulates amounts in excess of $1.6 million, they will be able to maintain this excess in accumulation phase (where earnings will be taxed at the concessional rate of 15 per cent).

The cap will be indexed in $100,000 increments in line with the consumer price index. A proportionate method which measures the percentage of the cap previously utilised will determine how much cap an individual has available at any point in time.

For example, if an individual has previously used up 75 per cent of their cap they will have access to 25 per cent of the current (indexed) cap. Subsequent fluctuations in retirement accounts due to earnings growth or pension payments will not be considered when calculating the remaining cap.

Existing pension balances

Members already in pension phase as at 1 July 2017 with balances in excess of $1.6 million will need to either:

- transfer the excess back into an accumulation; or
- withdraw the excess amount from their superannuation.

Individuals who breach the cap will be subject to a tax on both the amount in excess of the cap and the earnings on the excess amount similar to the tax treatment that applies to excess non-concessional contributions.

The Government has also confirmed commensurate treatment for members of defined benefit schemes will be achieved through changes to the tax arrangements for pension amounts over $100,000 from 1 July 2017 (see Defined Benefit Scheme Changes below).

FirstTech comment

This proposal will allow couples to have a combined pension balance of up to $3.2 million. However, where most of a couple's superannuation savings are in one spouses name the $500,000 lifetime non-concessional cap will restrict a couple's ability to equalise their benefits to take full advantage of the transfer balance cap.

The requirement for member's with balances already in excess of $1.6 million to either withdraw or transfer the amount in excess of the cap back to superannuation means that people with pension account balances in excess of $1.6 million have not been grandfathered from these changes.

In this case, this may also result in impacted members with SMSFs or super wrap accounts disposing of assets prior to transferring back to accumulation so as to ensure any capital gains are crystallised while the assets are still in pension phase and exempt.

Additional 15% contributions tax: threshold reduces to $250,000

Effective 1 July 2017

Division 293 tax, which is an additional 15% contributions tax payable by high income earners with income exceeding $300,000, will apply to those with income exceeding $250,000 from 1 July 2017.

The Government claims reducing the Division 293 tax income threshold will improve sustainability and fairness in the superannuation system by limiting the effective tax concessions provided to high income individuals.

The following table compares the tax concessions applicable on concessional contributions at various marginal tax rates:

Marginal tax rate*	Contributions Tax	Tax Concession
21%	15%	6%
34.5%	15%	19.5%
39%	15%	24%
49%	15%	34%
49%	30%**	19%

*Including Medicare Levy and Temporary Budget Repair Levy
**Includes additional 15% contributions tax (Division 293)

It is important to note the definition of income for Division 293 purposes includes:

- Taxable income (including the net amount on which family trust distribution tax has been paid)
- Reportable fringe benefits
- Total net investment loss (including net financial investment loss and net rental property loss)
- Low tax contributions (non-excessive concessional contributions) including super guarantee, salary sacrifice and personal concessional contributions.

Division 293 tax will apply to any low tax contributions that exceed the $250,000 threshold, assuming they form the top slice of income.

FirstTech Comment

The overall impact of this measure will be to increase the tax burden by up to $3,750 (i.e. 15% of $25,000) on concessional contributions. However concessional contributions still offer a tax concession of 19% for those paying Division 293 tax so it is unlikely to significantly reduce the level of concessional superannuation contributions.

Inadvertently exceeding the $250,000 threshold will be a key concern if the proposed changes are legislated. Examples that may cause a client to exceed the $250,000 threshold include taxable capital gains and employer termination payments.

Clients will not receive a Division 293 notice from the ATO until up to 18 months after making the concessional contribution which may come as a surprise to those unaware that they have exceeded the threshold. The tax can be paid personally or via a release authority from their superannuation fund.

Another important implication of this proposal is the increased cost of funding insurance in superannuation using concessional contributions for those subject to Division 293 tax.

Transition to retirement pensions: removal of earnings tax exemption

Effective 1 July 2017

The tax exempt status of income from assets supporting transition to retirement (TTR) income streams will be removed from 1 July 2017. Earnings will then be taxed at 15 per cent. This change applies irrespective of when the TTR income stream commenced, ie. no grandfathering applies.

The Government states that reducing the tax concessional nature of transition to retirement income streams will ensure they are fit for purpose and not primarily accessed for tax minimisation purposes.

Further, individuals will no longer be able to treat certain superannuation income stream payments as lump sums for tax purposes, which currently makes them tax-free up to the low rate cap of $195,000. For more information on this issue see FirstTech Strategic Update 'Taxing TTR payments as lump sums'.

FirstTech Comment

Taxing earnings on TTR income streams significantly reduces the tax effectiveness of strategies such as TTR and salary sacrifice. For clients aged 60 or over, TTR strategies may still be worthwhile as pension payments are tax free and allow tax effective salary sacrifice contributions. However for clients under age 60, the tax benefits are minimal.

The taxation of earnings in pension phase will only apply to 'transition to retirement' income streams where the client has reached preservation age but not yet retired. Presumably income streams where the client has met a full condition of release such as retirement will continue to have the earnings tax exemption apply. Clients may look at arrangements involving ceasing a gainful employment arrangement over age 60 or ceasing work and declaring permanent retirement to meet the retirement condition of release.

From a superannuation fund perspective, administering the taxation of earnings in pension phase for transition to retirement pensions will add complexity.

Increased access to spouse superannuation tax offset

Effective 1 July 2017

The current spouse superannuation tax offset will be available to more people due to an increase in the spouse income threshold from 1 July 2017.

The income threshold for the spouse superannuation tax offset is increasing from $10,800 to $37,000.

A contributing spouse will be eligible for an 18 per cent offset worth up to $540 for contributions made to an eligible spouse's superannuation account.

FirstTech Comment

Currently the spouse superannuation tax offset reduces where the spouse's income exceeds $10,800 and cuts out altogether when their income reaches $13,800.

If the same methodology applies, the tax offset would reduce where the spouse's income exceeds $37,000 and cut out altogether at $40,000.

Low income superannuation tax offset

Effective 1 July 2017

A Low Income Superannuation Tax Offset (LISTO) will be introduced from 1 July 2017 to reduce tax on superannuation contributions for low income earners.

The LISTO will provide a non-refundable tax offset to superannuation funds, based on the tax paid on concessional contributions up to a cap of $500. The LISTO will apply to members with adjusted taxable income up to $37,000 that have had a concessional contribution made on their behalf.

The ATO will determine a person's eligibility for the LISTO and advise their superannuation fund annually. The fund will contribute the LISTO to the member's account.

FirstTech comment

The LISTO replaces the Low Income Superannuation Contribution (LISC) rules that were due to be abolished on 1 July 2017.

Similar to LISC, the LISTO provides a contribution of 15% of the value of a member's concessional contributions up to a cap of $500 where the member has adjusted taxable income of less than $37,000.

Anti-detriment payments abolished

Effective 1 July 2017

Anti-detriment provisions will be abolished from 1 July 2017, effectively removing the ability of superannuation funds to increase lump sum superannuation death benefits when paid to eligible beneficiaries.

The anti-detriment provisions allow a superannuation fund to claim a corresponding tax deduction where it is able to increase the amount of a member's death benefit paid to certain eligible beneficiaries to compensate for the impact of tax on contributions.

The Government says removing the anti-detriment provision will better align the treatment of lump sum death benefits across all superannuation funds and the treatment of bequests outside of superannuation.

FirstTech comment

If this proposal is legislated as announced, eligible beneficiaries will no longer qualify to have a death benefit payment uplifted by 17.65% (under the formula method). This may result in more beneficiaries electing to receive their benefit in the form of a death benefit income stream.

This change will also mean that re-contribution strategies will no longer adversely impact beneficiaries that would have qualified as eligible beneficiaries for an anti-detriment payment. However, the ability to implement a recontribution strategy will be restricted if the $500,000 life-time non-concessional cap is introduced.

Finally anti-detriment payments have traditionally been very difficult for Self-Managed Superannuation Funds (SMSFs) to pay compared to large funds, as these payments needed to be funded by the super fund first with the trustee then qualifying for a corresponding deduction of the same value. This announcement will remove this competitive disadvantage for SMSFs.

Extend deductions for personal contributions

Effective 1 July 2017

Australians under 75 will be able to claim an income tax deduction for any personal superannuation contributions made to a complying superannuation fund up to their concessional cap. This effectively allows all individuals, regardless of their employment circumstances, to claim a deduction for their personal contributions up to the value of the concessional cap.

To access the tax deduction, individuals will need to lodge a notice of their intention to claim the deduction with their superannuation fund or retirement savings provider prior to lodging their tax return. These amounts will count towards the individual's concessional contributions cap, and be subject to 15 per cent contributions tax. Individuals can choose how much of their contributions to deduct however if they end up exceeding their concessional cap the deduction claimed on the excess contributions will have no effect as these amounts will be included back into the member's assessable income.

Individuals that are members of certain prescribed funds would not be entitled to deduct contributions to those schemes. Prescribed funds will include all untaxed funds, all Commonwealth defined benefit schemes, and any State, Territory or corporate defined benefit schemes that choose to be prescribed.

FirstTech comment

This announcement will dramatically simplify the eligibility requirements for a member to qualify to claim a deduction for a personal super contribution. The requirement to not be an employee during the financial year or to satisfy the 10% test will be replaced with a simple requirement to be under age 75.

The announcement also gives employees more flexibility and allows them to make personal deductible contributions in addition to super guarantee and salary sacrifice contributions, to use up any unused concessional cap at the end of the year.

Defined benefit scheme changes

Effective 1 July 2017

The Government has announced a range of reforms to the taxation of benefits paid from defined benefit schemes and constitutionally protected funds to ensure equitable treatment of members in these funds and accumulation.

$1.6 million transfer balance cap

To broadly replicate the effect of the proposed $1.6 million transfer balance cap, the Government has announced that pension payments over $100,000 per annum paid to members of unfunded defined benefit schemes and constitutionally protected funds providing defined benefit pensions, will continue to be taxed at full marginal rates, however the 10 per cent tax offset will be capped at $10,000 from 1 July 2017.

For members of funded defined benefit schemes, 50 per cent of pension amounts over $100,000 per annum will now be taxed at the individual's marginal tax rate.

Retirement income product innovation – tax exemptions extended

Effective 1 July 2017

The tax exemption on earnings in retirement phase will be extended to products such as deferred lifetime annuities and group self-annuitisation products.

The Government says this will allow providers to offer a wider range of retirement income products which will provide more flexibility and choice for Australian retirees, and help them to better manage consumption and risk in retirement, particularly longevity risk, wherein people outlive their savings.

The Government also said it will consult on how these new products are treated under the age pension means test.

FirstTech comment

It is expected that this announcement will lead to the development of deferred annuity products which will allow clients to combine these types of products with traditional account based pensions to better manage their income requirements and longevity risk during retirement.

Enshrine objectives of super in law

Enshrine in law an objective for superannuation to provide income in retirement to substitute or supplement the Age Pension.

The Government says it will embed the objective of superannuation in a stand-alone Act, with an accountability mechanism to ensure that new superannuation legislation is considered in the context of the objective.

Taxation

Reducing the company tax rate to 25 per cent

Effective from 1 July 2016

The company tax rate will be reduced to 25 per cent over 10 years. Currently, small business companies with aggregated turnover less than $2 million pay tax at rate of 28.5%. Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

PROPOSED REDUCTION TO COMPANY TAX RATES

Financial year	Companies with annual aggregated turnover of less than	Applicable company tax rate
2016-17	$10 million	27.5%
2017-18	$25 million	27.5%
2018-19	$50 million	27.5%
2019-20	$100 million	27.5%
2020-21	$250 million	27.5%
2021-22	$500 million	27.5%
2022-23	$1 billion	27.5%
2024-25	All companies	27%
2025-26	All companies	26%
2026-27	All companies	25%

FirstTech comment

Under the current small business tax concessions for small businesses the franking credit that can be allocated to a frankable distribution remained at 30%.

However, under this proposal franking credits will only be able to be distributed in line with the rate of tax paid by the company making the distribution.

Small business entity aggregated turnover threshold increased

Effective 1 July 2016

The small business entity turnover threshold will be increased from $2m to $10m for the purposes of accessing certain existing income tax concessions.

This will allow more business entities to gain access to the small business concessions, such as:

- simplified depreciation rules, including immediate tax deductibility for asset purchases costing less than $20,000 until 30 June 2017 and then less than $1,000
- simplified trading stock rules, giving businesses the option to avoid an end of year stocktake if the value of the stock has changed by less than $5,000
- a simplified method of paying PAYG instalments calculated by the ATO, which removes the risk of under or over estimating PAYG instalments and the resulting penalties that may be applied
- the option to account for GST on a cash basis and pay GST instalments as calculated by the ATO, and
- other tax concessions available to small business currently, such as the Fringe Benefits Tax concessions (from 1 April 2017, the beginning of the next fringe benefit tax year)

The increased threshold will not apply for the purpose of accessing existing small business capital gains tax concessions.

Access to the unincorporated small business tax discount will be limited to entities with turnover less than $5 million.

Increase the unincorporated small business tax discount

Effective 1 July 2016

The unincorporated small business tax discount will be increased in phases over 10 years from the current 5% to 16%. The following table is a summary of when the discount rates will apply.

PROPOSED DISCOUNT RATES

Financial year	Discount rate
2016-17	8%
2017-18 to 2024-25	10%
2025-26	13%
2026-27+	16%

Individual taxpayers with business income from an unincorporated business that has aggregated annual turnover of less than $5M will be eligible for this tax discount. The discount is currently 5% of the income tax payable on business income received from an unincorporated small business entity. The current cap of $1,000 per individual for each income year will be retained.

Personal income tax reduction

Effective 1 July 2017

The Government will increase the 32.5 per cent personal income tax threshold from $80,000 to $87,000 from 1 July 2016.

This measure will reduce the marginal rate of tax on income between $80,000 and $87,000 from 37 per cent to 32.5 per cent. This will ensure that the average full-time wage earner will not move into the second highest tax bracket in the next three years.

PERSONAL TAX RATES

Current tax rates 2015-16		Proposed tax rates 2016-17	
Taxable Income	Tax Payable *	Taxable Income	Tax Payable *
$0 - $18,200	0%	$0 - $18,200	0%
$18,201 - $37,000	19% over $18,200	$18,201 - $37,000	19% over $18,200
$37,001 - $80,000	$3,572 + 32.5% over $37,000	$37,001 - $87,000	$3,572 + 32.5% over $37,000
$80,000 - $180,000	$17,547 + 37% over $80,000	$87,000 - $180,000	$19,822 + 37% over $87,000
$180,000+	$54,547 + 45% over $180,000	$180,000+	$54,232 + 45% over $180,000

*Excludes Medicare Levy and Temporary Budget Repair Levy

FirstTech Comment

A taxpayer earning $87,000 will save $315 per annum as a result of the change to the personal income tax threshold.

Pausing indexation of the Medicare Levy Surcharge and Private Health Insurance Rebate Thresholds

Effective 1 July 2018

The Government will continue the pause on indexation of the income thresholds for the Medicare Levy Surcharge and Private Health Insurance Rebate for a further three years from 1 July 2018.

Social Security

Simplifying student payments

Effective 1 January 2017

Means testing arrangements for students and other payment recipients will be simplified from 1 January 2017. The changes include aligning the:

- assets test for all Youth Allowance and Austudy recipients, including those partnered to a Social Security or Veterans' Affairs income support recipient
- means test rules used to assess interests in trusts and private companies for all student payment recipients, including independent Youth Allowance and ABSTUDY recipients
- social security benefit and ABSTUDY income test treatment of gift payments from immediate family members with existing pension rules, and
- Family Tax Benefit (FTB) income test and youth Parental Income Test, and authorising the use of FTB income details for the youth Parental Income Test

Effective 1 January 2019

- Student income support recipients will be automatically issued with a Health Care Card from 1 January 2019. This change will allow Youth Allowance (student), Austudy and ABSTUDY recipients to be automatically issued a Health Care Card at the same time as their grant of payment.

Social security savings

A range of social security measures aimed at savings to fund the National Disability Insurance Scheme are proposed.

- New welfare recipients from 20 September 2016 will not be eligible for carbon tax compensation.
- Backdating provisions for new Carer Allowance claims will be aligned with other social security payments. From 1 January 2017, Carer Allowance will be payable to eligible applicants from the date of the claim, or the date they first contact the Department of Human Services.
- Increased reviews of Disability Support Pension recipients by assessing their capacity to work.

How to contact us

Adviser Services 13 18 36

firsttech@colonialfirststate.com.au