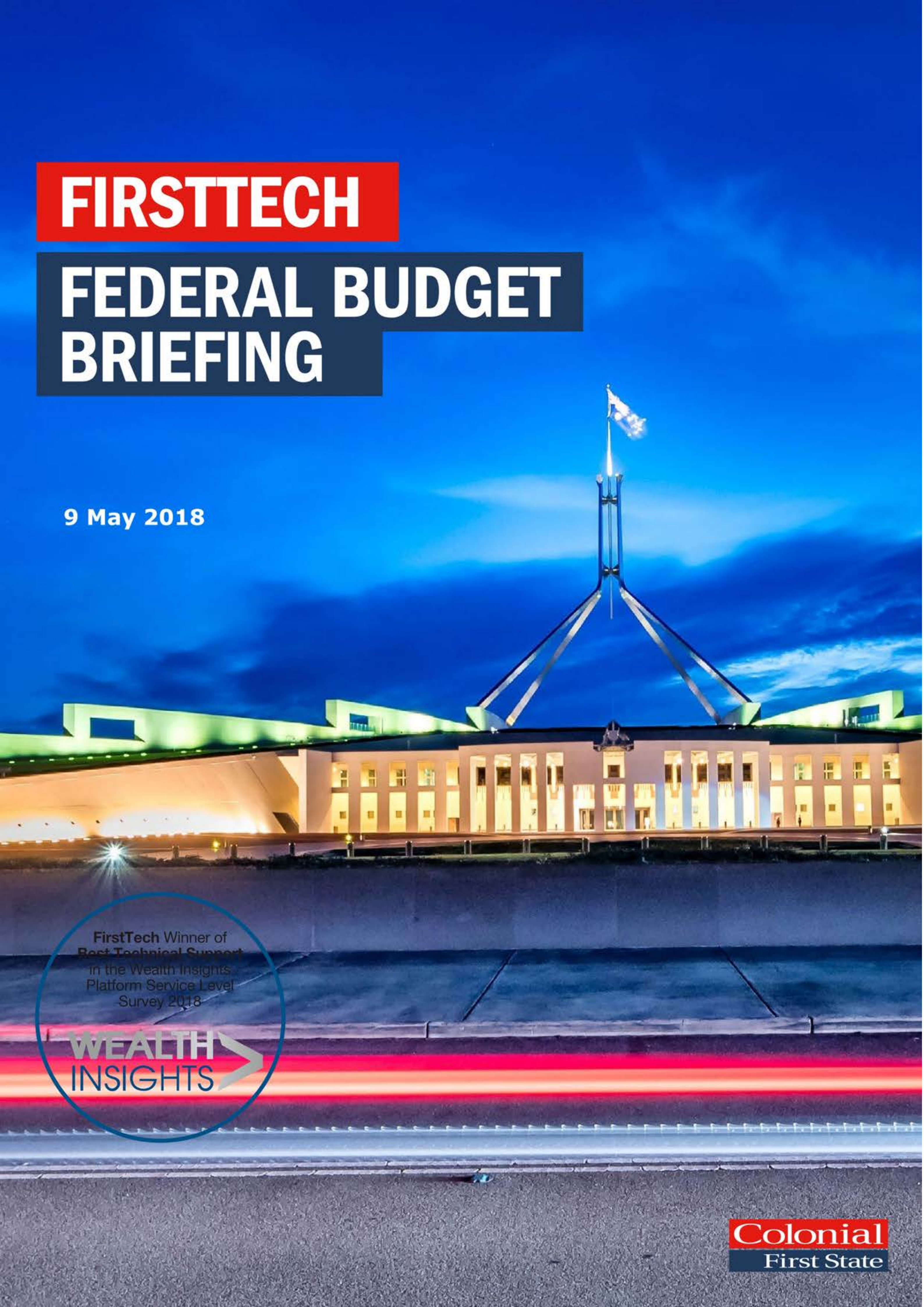
FIRSTTECH
FEDERAL BUDGET BRIEFING

9 May 2018



FirstTech Winner of Best Technical Support in the Wealth Insights Platform Service Level Survey 2018

WEALTH INSIGHTS

Colonial First State

Table of Contents

Introduction

Last night the federal government handed down its Budget for the 2018–19 year, which is likely to be the final Budget before the next federal election. It's therefore hardly surprising that the Coalition promised to deliver a suite of tax cuts for individuals at various income levels, as well as a range of incentives to support older Australians.

Some key Budget announcements that financial advisers and their clients should be aware of include:

- immediate tax breaks for low-to-middle income earners and future tax cuts for higher earners
- a limited exemption from the work test for super contributions, for workers aged 65–74 who have super balances below $300,000
- new means test rules for lifetime retirement income streams to help reduce longevity risk
- an increase to the maximum number of SMSF members from 4 to 6, to provide more flexibility for larger families.

Finally, it's important to remember that the Budget announcements are still only proposals at this stage. Each of the proposals must be passed by parliament in due course before they're legislated.

Taxation

Seven year personal income tax plan

The Government will introduce a Personal Income Tax Plan over a seven year period that involves 3 steps:

- **Step 1: 2018-19 to 2021-22** o Introduction of a Low and Middle Income Tax Offset of up to $530pa, in addition to Low Income Tax Offset (LITO), from 2018-19 to 2021-22 o Extend the top threshold for the 32.5% personal income tax bracket from $87,000 to $90,000
- **Step 2: 2022-23 to 2023-24** o Extend the top threshold for the 19% personal income tax bracket from $37,000 to
  $41,000 o Extend the top threshold for the 32.5% personal income tax bracket from $90,000 to
  $120,000 o Increase LITO from $445 to $645
- **Step 3: 2024-25 and later financial years** o Removal of the 37% personal income tax bracket
  o Extend the top threshold for the 32.5% personal income tax bracket from $120,000 to $200,000

Below is an analysis of the Personal Income Tax Plan in detail:

Step 1: 2018-19 to 2021-22

The Government will introduce a new tax offset called the Low and Middle Income Tax Offset (LMITO). This is in addition to the Low Income Tax Offset (LITO).

LMITO is a non-refundable tax offset of up to $530 per annum payable to Australian residents on low and middle incomes. The offset will be available for the 2018-19, 2019-20, 2020-21 and 202122 income years and will be received as a lump sum on assessment after an individual lodges their tax return.

Low and Middle Income Tax Offset

Taxable income (TI)	*Change in offset (CI)*	*Maximum offset*
$0 - $37,000	*Nil*	*$200*
$37,001 - $48,000	*(TI - $37,000) x 0.03*	*$200 + CI*
$48,001 - $90,000	*Nil*	*$530*
$90,001 - $125,333	*(TI - $90,000) x 0.015*	*$530 - CI*

The Government will also increase the top bracket of the 32.5% personal income tax bracket from $87,000 to $90,000.

Changes to personal income tax brackets

2017-18 (Current)		*2018-19 to 2021-22 (Proposed)*	
Taxable income	*Rate*	*Taxable income*	*Rate*
$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 - $87,000	*$3,572 + 32.5% over $37,000*	*$37,001 -* ***$90,000***	*$3,572 + 32.5% over $37,000*
$87,001 - $180,000	*$19,822 + 37% over $87,000*	***$90,001*** *- $180,000*	*$20,797 + 37% over $90,000*
$180,001 +	*$54,232 + 45% over $180,000*	*$180,001 +*	*$54,097 + 45% over $180,000*

The following table details the tax savings for 2018-19 to 2021-22 compared to the current tax laws

Taxable income	*Tax savings**
$20,000	*$0*
$30,000	*$200*
$40,000	*$290*
$50,000	*$530*
$60,000	*$530*
$70,000	*$530*
$80,000	*$530*
$90,000	*$665*
$100,000	*$515*
$110,000	*$365*
$120,000	*$215*
$130,000	*$135*

**Incorporates increase in Medicare Levy thresholds from 1 July 2018*

Step 2: 2022-23 to 2023-24

- Extend the 19% personal income tax bracket from $37,000 to $41,000.
- Extend the 37% personal income tax bracket from $90,000 to $120,000
  - ☐ Increase LITO from $445 to $645

Changes to personal income tax brackets

2017-18 (Current)		*2018-19 to 2021-22 (Step 1)*		*2022-2023 to 2023-2024 (Step 2)*	
Taxable income	*Rate*	*Taxable income*	*Rate*	*Taxable income*	*Rate*
$0 - $18,200	*0%*	*$0 - $18,200*	*0%*	*$0 - $18,200*	*0%*
$18,201 - $37,000	*19% over $18,200*	*$18,201 - $37,000*	*19% over $18,200*	*$18,201 - **$41,000***	*19% over $18,200*
$37,001 - $87,000	*$3,572 + 32.5% over $37,000*	*$37,001 - **$90,000***	*$3,572 + 32.5% over $37,000*	*$41,001 - **$120,000***	***$4,332**+ 32.5% over **$41,000***
$87,001 - $180,000	*19,822 + 37% over $87,000*	***$90,001** - $180,000*	*$20,797+ 37% over $90,000*	***$120,001** - $180,000*	***$30,007** + 37% over **$120,000***
$180,001 +	*$54,232 + 45% over $180,000*	*$180,001 +*	*$54,097 + 45% over $180,000*	*$180,001 +*	***$52,207**+ 45% over $180,000*

Changes to Low Income Tax Offset

2017-18 to 2021-2022			*2022-23 (Proposed)*		
Taxable income (TI)	*Reduction in offset (RI)*	*Maximum offset*	*Taxable income (TI)*	*Reduction in offset (RI)*	*Maximum offset*
$0 - $37,000	*Nil*	*$445*	*$0 - $37,000*	*Nil*	*$645*
$37,001 - $66,666	*(TI -$37,000) x 0.015*	*$445 - RI*	*$37,001 - $41,000*	*(TI - $37,000) x 0.065*	*$645 - RI*
			$41,001 - $66,667	*(TI - $41,000) x 0.015*	*$385 - RI*
$66,667+	*$445*	*Nil*	*$66,667+*	*$645*	*Nil*

Tax savings from 1 July 2022 compared to current tax rates (2017-18 FY)

Taxable income	*Tax savings (Step 2) compared to 2017-18*
$20,000	$0
$30,000	$200
$40,000	$455
$50,000	$540
$60,000	$540
$70,000	$540
$80,000	$540
$90,000	$675
$100,000	$1,125
$110,000	$1,575
$120,000	$2,025
$130,000	$2,025

Step 3: 2024-25 financial year and future years

- Remove the 37% tax bracket entirely
- Extend the top threshold of the 32.5% personal income tax bracket from $120,000 to $200,000.

Changes to personal income tax brackets

2018-19 to 2021-22 (Step 1)		*2022-2023 to 2023-2024 (Step 2)*		*2024-25 and future years (step 3)*	
Taxable income	*Rate*	*Taxable income*	*Rate*	*Taxable income*	*Rate*
$0 - $18,200	*0%*	*$0 - $18,200*	*0%*	*$0 - $18,200*	*$0*
$18,201 - $37,000	*19% over $18,200*	*$18,201 -* ***$41,000***	*19% over $18,200*	*$18,201 - $41,000*	*19% over $18,200*
$37,001 - ***$90,000***	*$3,572 + 32.5% over $37,000*	*$41,001 -* ***$120,000***	***$4,332****+ 32.5% over* ***$41,000***	*$41,001 -* ***$200,000***	*$4,332 + 32.5% over $41,000*
$90,001 *- $180,000*	*$20,797+ 37% over $90,000*	***$120,001*** *- $180,000*	***$30,007*** *+ 37% over* ***$120,000***		
$180,001 +	*$54,097 + 45% over $180,000*	*$180,001 +*	***$52,207****+ 45% over $180,000*	***$200,001 +***	***$56,007*** *+ 45%*

Tax savings from 1 July 2024 compared to current tax rates (2017-18 FY)

Taxable income	*Tax savings (Step 3) compared to 2017-18*
$20,000	$0
$30,000	$200
$40,000	$455
$50,000	$540
$60,000	$540
$70,000	$540
$80,000	$540
$90,000	$675
$100,000	$1,125
$110,000	$1,575
$120,000	$2,025
$130,000	$2,475
$140,000	$2,925
$150,000	$3,375
$160,000	$3,825
$170,000	$4,275
$180,000	$4,725

$190,000	$5,975
$200,000	$7,225
$210,000	$7,225
$220,000	$7,225
$230,000	$7,225
$240,000	$7,225

Tax integrity measure for testamentary trusts

Effective 1 July 2019

The Government has announced concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets transferred from a deceased estate or proceeds from the disposal or investment of those assets.

This measure aims to prevent minors from obtaining the benefit of adult marginal tax rates on a higher amount of income by transferring assets that are unrelated to a deceased estate into a testamentary trust.

Retaining the Medicare levy at 2 per cent

Effective 1 July 2019

The Government will not increase the Medicare Levy rate from 2 to 2.5 per cent of taxable income as legislated to commence from 1 July 2019. Consequential changes to other tax rates linked to the top personal tax rate such as the fringe benefits tax rate, will also not proceed.

Increasing the Medicare Levy low-income thresholds

Effective 1 July 2018

The Government will increase the Medicare levy low-income thresholds for singles, families, and seniors and pensioners from the 2017-18 income year.

The following table compares the level of taxable income below which no Medicare Levy is payable.

	2016-17	*2017-18*
Taxpayers entitled to seniors and pensioner tax offset		
Individual	*$34,244*	*$34,758*
Married or sole parent	*$47,670*	*$48,385*
For each dependent child or student, add:	*$3,356*	*$3,406*
All other taxpayers		
Individual	*$21,655*	*$21,980*
Couple/sole parent (family income)	*$36,541*	*$37,089*

Extending accelerated depreciation for small businesses

Effective 1 July 2018

The Government will extend the existing $20,000 instant asset write-off by a further 12 months to 30 June 2019 for businesses with aggregated annual turnover of less than $10 million. Under this measure, small businesses will be able to immediately deduct purchases of eligible assets costing less than $20,000 where they are installed and ready for use before 30 June 2019.

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the small business simplified depreciation pool and depreciated at 15 per cent in the first income year and 30 per cent each income year thereafter. The pool can also be immediately deducted if the balance is less than $20,000 over this period (including existing pools).

Small business CGT concession integrity measure in relation to partnerships

Effective 8 May 2018

The small business CGT concessions will no longer be available to partners that alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership. This is a tax integrity measure to stop certain taxpayers, including large partnerships, from accessing these concessions in relation to their assignment of a right to the future income of a partnership to an entity, without giving that entity any role in the partnership.

There are no changes to the small business CGT concessions themselves.

Removing the capital gains discount at the trust level for Managed Investment Trusts and Attribution MITs

Effective 1 July 2019

The Government will prevent Managed Investment Trusts (MITs) and Attribution MITs (AMITs) from applying the 50% capital gains discount at the trust level from 1 July 2019. However, under this measure MITs and AMITs will still be able to distribute realised capital gains that can then be discounted in the hands of the beneficiary.

Deductions denied for vacant land

Effective 1 July 2019

The Government will deny deductions for expenses associated with holding vacant land. The Government says this is an integrity measure to address concerns that deductions are being improperly claimed for expenses, such as interest costs, relating to holding vacant land, where the land is not genuinely held for the purpose of earning assessable income.

Expenses for which deductions will be denied that would ordinarily be included in an asset's cost base, such as borrowing expenses and council rates, may be included in the cost base of the asset for capital gains tax (CGT) purposes when sold. However, denied deductions for expenses that would not ordinarily be a cost base element would not be able to be included in the cost base of the asset for CGT purposes.

The Government has confirmed this measure will not apply to expenses associated with holding land that are incurred after:

- a property has been constructed on the land, it has received approval to be occupied and is available for rent; or
- the land is being used by the owner to carry on a business, including a business of primary production.

This measure will apply to land held for residential or commercial purposes. However, the ‘carrying on a business’ test will generally exclude land held for commercial development.

Superannuation

Superannuation work test exemption for retirees

Effective 1 July 2019

The Government intends to amend the superannuation contribution rules to allow people aged 65 to 74 that have a total superannuation balance of under $300,000 to make voluntary contributions for 12 months from the end of the financial year they last satisfied the work test. This will give people more time to make contributions to super after they have retired and finished working.

For example, if a client retired on 30 March 2020, they would be able to make voluntary concessional and/or non-concessional contributions during the 2020-21 financial year where their total superannuation balance was under $300,000 on 30 June 2020. In this case, the normal contribution caps will apply, including the ability to make additional contributions under the catch-up concessional contribution rules.

FirstTech Comment

The changes to the work test will provide more flexibility for clients with small balances to make additional contributions to super after retirement.

However, linking eligibility to a client’s total superannuation balance will increase the complexity of providing super contribution advice as it applies yet another balance threshold that advisers will need to be aware of and check prior to recommending a client make any contributions.

SMSF membership increasing to six

Effective 1 July 2019

The Government will amend the definition of Self-Managed Superannuation Funds (SMSFs) in the SIS Act to increase the maximum number of members in new and existing funds from four to six.

This change is also proposed to apply to Small APRA Funds from the same date.

FirstTech Comment

While this announcement will provide more flexibility for larger families to structure themselves into a single fund, the uptake is likely to be only minor as currently only about 7% of SMSFs have more than two members*.

However, where new or existing funds do take advantage of the new rules careful consideration will need to be given to a range of issues. These will include:

- the need for multiple investment strategies to cater for members with different risk profiles, and
- the need for a corporate trustee to avoid the risk of additional trustee penalties and to address the increased risk of changes in fund membership.

Larger SMSF membership may also result in increased risk of trustee dispute. Therefore, members may need to carefully consider the fund's voting rules in the trust deed and confirm whether proportional voting rules should apply and whether some important decisions, such as the payment of death benefits, should require a unanimous decision.

*ATO SMSF quarterly statistical report – December 2017

Three year audit cycle for some SMSFs

Effective 1 July 2019

The Government will allow certain SMSFs to move from an annual to a three-yearly audit cycle where they have:

- three consecutive years of clear audit reports, and
- lodged the fund's annual returns in a timely manner.

FirstTech Comment

This announcement may make SMSFs with a good compliance and lodgement record cheaper to operate as it will remove the need for an annual audit. However, it could also make any compliance breaches that do occur more serious as it could be up to three years before a breach is detected, which may make them harder and more costly to rectify.

Preventing inadvertent concessional cap breaches

Effective 1 July 2018

The Government will allow individuals whose income exceeds $263,157 and who have multiple employers to nominate that their wages from certain employers are not subject to the superannuation guarantee (SG).

The government says this measure is being introduced to allow eligible individuals to avoid unintentionally breaching the $25,000 annual concessional contributions cap as a result of multiple compulsory SG contributions. In this case, the employee will be able to negotiate to receive additional salary and wages to make up for the lost SG contributions.

FirstTech Comment

At this stage it is unclear if this rule will apply to all of the income a member receives from a nominated employer or just the amount that exceeds $263,157. For example, if a client earned $140,000 from two different employers and they nominated for SG not to apply to the income received from one of those employers, would SG not apply to the whole $140,000 or just that amount of income that exceeds $263,157?

Personal deductible contribution notice of intent integrity changes

Effective 1 July 2018

The ATO will modify income tax returns to require individuals to confirm they have provided a valid notice of intent to their fund when claiming a tax deduction for their personal contributions. The ATO will also provide guidance to individuals on how to comply if they have not yet done so.

The Government says this measure will ensure that any deductible contributions are appropriately taxed by superannuation funds and enable the ATO to deny deductions to individuals who do not comply with the NOI requirements.

Changes to insurance in superannuation

Effective 1 July 2019

The Government will change the insurance arrangements for certain categories of superannuation members. Insurance within superannuation will move from a default framework to be offered on an opt-in basis for the following groups of members:

- low balances of less than $6,000
- under the age of 25 years
- whose accounts have not received a contribution in 13 months and are inactive.

The government says these changes are required to protect the retirement savings of young people and those with low balances by ensuring their superannuation is not unnecessarily eroded by premiums on insurance policies they do not need or are not aware of. The government also says the changes will reduce the incidence of duplicate cover.

Impacted members will have approximately 14 months from budget night to decide whether they will opt-in to the existing cover or allow it to switch-off.

Capping fees, banning exit fees and reuniting small and inactive superannuation accounts

Effective 1 July 2019

The Government has announced it will introduce a 3% annual cap on passive fees charged by superannuation funds on accounts with balances below $6,000 and will ban exit fees on all superannuation accounts.

The Government also announced it will require all inactive superannuation accounts with balances below $6,000 to be transferred to the ATO. The ATO will then use data matching to proactively reunite these inactive accounts with a member’s active account, where possible.

Measures for older Australians

Increase to Pension Work Bonus

Effective 1 July 2019

The Pension Work Bonus encourages age/service pensioners to remain in the workforce by disregarding an amount of employment income from the pension income test.

Under current rules, the Pension Work Bonus allows pensioners to disregard up to the first $250pf of employment income. Under the proposed changes, the amount of employment income that will be disregarded will increase to $300pf.

Pensioners will continue to accrue unused amounts of the fortnightly Pension Work Bonus, which can exempt future earnings from the pension income test. The maximum accrual amount will increase from $6,500 to $7,800.

In addition, the Pension Work Bonus will be extended to earnings from self-employment.

FirstTech Comment

The Pension Work Bonus is in addition to the income free area. This allows a single pensioner with no other income to earn up to $468pf in employment income and receive the maximum age pension.

The Government also announced that they are introducing a ‘personal exertion’ test to ensure the Pension Work Bonus only applies to actual engagement in gainful work.

Extending eligibility to the Pension Loan Scheme

Effective 1 July 2019

The Pension Loans Scheme is a voluntary reverse mortgage provided by Centrelink. Under current rules, the scheme allows clients to “top-up” their age pension up to the maximum rate where they receive a part pension due to the income or asset test, or do not receive an age pension under either the income or assets test (but not both). The amount of “top-up” payments are a loan secured against Australian real estate which must be repaid when the property is sold or the client passes away.

From 1 July 2019, the Government will expand the scheme by:

- extending eligibility to all clients of age pension age including maximum rate age pensioners, and
- increasing the maximum amount of “top-up” payments from 100% to 150% of the maximum rate of age pension.

Maximum rate age pensioners will be able to increase their income by up to $11,799 (singles) or $17,787 (couples) per year.

While the overall maximum amount of “top-up” payments is 150% of the maximum rate of Age Pension, the actual limit depends on the clients age, how long they intend to receive payments, whether they are single or partnered, the value of their home and the rate of Age Pension they receive. These restrictions ensure they do not have to pay back more than their home is worth.

FirstTech Comment

The Budget paper states that the Pension Loans Scheme will be available to "everyone over Age Pension age" which implies that self-funded retirees will have access to the scheme.

Currently the Pension Loans Scheme is not widely used. It will be interesting to see whether the proposed changes increase the number of clients who utilise the scheme.

Means testing of pooled lifetime products

Effective 1 July 2019

From 1 July 2019, new Age Pension means testing rules will be introduced for pooled lifetime income streams.

Under the new rules:

- 60% of all income payments will be assessed as income, and
- 60% of the purchase price will be assessed as an asset until age 84, or a minimum of 5 years, and then 30% of the purchase price will be assessed as an asset for the rest of the person's life.

The Government states that "the new rules will provide industry with the confidence and stability to develop innovative products that can help retirees manage the risk of outliving their income, while ensuring a fair and consistent means test treatment of all retirement income products. These changes also pave the way for the development of CIPRs."

Existing pooled lifetime income streams purchased before 1 July 2019 will be grandfathered.

The Government will require providers of retirement income products to report simplified, standardised metrics in product disclosure to assist customer decision making.

FirstTech comment

As announced in the 2016-17 Federal Budget, the Government previously implemented legislation enabling superannuation funds and life insurance companies to offer a new range of "innovative retirement income stream products" from 1 July 2017.

The legislation introduced a new set of design rules for lifetime superannuation income stream products aimed at enabling retirees to better manage consumption and longevity risk in retirement. The new rules covered a range of income stream products including deferred products, investment-linked pensions and annuities and group self-annuitised products that allow the pooling of risk. However due to uncertainty as to how these products would be assessed under the social security means test there has been limited product development.

The clarification of the social security means testing of these products will likely encourage product development in this area.

It is unclear from the Budget announcement exactly which income streams will meet the definition of "pooled lifetime income streams". Previous position papers from the Department of Social Services indicated that existing rules for the assessment of lifetime income streams would be amended to provide consistent treatment.

However the Budget announcement does make it clear that existing pooled lifetime income streams purchased before 1 July 2019 will be grandfathered.

Comprehensive Income Products for Retirement (CIPR)

Effective date not specified

The Government will introduce a retirement income covenant in the Superannuation Industry (Supervision) Act 1993 requiring trustees to develop a strategy that would help members achieve their retirement income objectives.

The covenant will require trustees to offer Comprehensive Income Products for Retirement (CIPRs) which provide lifetime income streams.

The Government will release a position paper for consultation outlining its proposed approach to the covenant.

Expansion of Home Care

Effective 1 July 2018

The Government will increase the number of high level home care packages that will be available over the next four years by 14,000. This increase is in addition to the 6,000 high level home care packages that were previously announced.

FirstTech comment

As at 31 December 2017, there were over 100,000 people in the national queue waiting for either their first home care package or an interim package, with 54.4% waiting for a high level home care package (level 4).

Residential aged care funding

Effective 1 July 2018

The Government will increase funding for residential aged care and short-term restorative care places in 2018-19 by $60 million to support new places.

In addition, they will provide $82.5 million to support mental health services for residents of aged care facilities as well as $61.7 million to make the My Aged Care website easier to use with simpler assessment forms for people to access aged care services.

National register of enduring powers of attorney

Effective date not specified

As part of a range of measures to protect the rights of older Australians from abuse, the Government will work with the States and Territories to establish a National Register of Enduring Powers of Attorney.

FirstTech comment

The introduction of a National Register of Enduring Powers of Attorney was included in the Elder Abuse Report from the Australian Law Reform Commissions handed down in June 2017.

In the Elder Abuse Report, reasons provided for the establishment of a National Register included:

- ensuring that only one enduring document can be registered at any one time
- enabling the easy identification of documents that are live (that is active because they commence on signing or because it has been appropriately confirmed that the principal no longer has relevant decision-making ability); and
- providing clarity as to the precise roles and powers of the attorney.

New income test for Carer Allowance

Effective 20 September 2018

Carer Allowance will be subject to an income test from 20 September 2018. Currently Carer Allowance is a non-means tested payment.

Under the new income test, the combined income of the carer and their partner must be under $250,000 per annum.

The income test for Carer Allowance will be similar to the income test for the Commonwealth Seniors Health Card. It will assess the carer and their partner's adjusted taxable income for the previous financial year.

From 20 September 2018, existing Carer Allowance recipients as well as people submitting a new claim for Carer Allowance who do not receive an income support payment will be asked to provide their income details.

Carer Allowance Health Care Card only claimants and recipients will also be affected.

How to contact us

Adviser Services 13 18 36

firsttech@colonialfirststate.com.au