TapIn Flash

For Adviser use only **2016/03**

4 May 2016

2016-17 Federal Budget – Adviser Briefing

Last night's Federal Budget contained a number of proposals that will impact the financial planning industry.

The commentary in this document is based on TapIn's initial observations and interpretation of the proposals based on the limited details provided in the Budget papers.

Importantly, these proposals require passage of legislation before they are implemented. TapIn will continue to monitor these proposals and issue further communications as more details emerge.

Superannuation

1. Lifetime cap for non-concessional superannuation contributions

Proposed effective date: 7:30 pm (AEST) 3 May 2016

Currently, the non-concessional contributions cap is $180,000 per person, per financial year. Where a person is under age 65 at any time in the financial year, they are able to make a non-concessional contribution of up to $540,000 under the bring-forward provisions.

The Government proposes to replace the current contribution cap with a $500,000 lifetime non-concessional contribution cap. This lifetime cap is proposed to commence at 7:30 pm (AEST) on **3 May 2016**. The cap will be indexed to average weekly ordinary time earnings (AWOTE).

The lifetime cap will take into account all non-concessional contributions made on or after **1 July 2007**.

Contributions made between 1 July 2007 and 3 May 2016 will be counted towards this lifetime cap. However, contributions made before commencement of this measure, that is 7:30 pm (AEST) on 3 May 2016, will **not** result in an excess.

Excess contributions made after commencement will need to be removed or be subject to penalty tax.

After-tax contributions made into defined benefit accounts and constitutionally protected funds will also be included in an individual's lifetime non-concessional cap. Special rules will apply to members of these schemes.

Observation:

- This may restrict a number of existing strategies, in particular the withdrawal and re-contribution strategy as well as Centrelink sheltering strategies.

2. Reduction of the concessional contribution cap

Proposed effective date: 1 July 2017

Currently, the standard concessional contribution (CC) cap is $30,000 per financial year. A higher temporary concessional contributions cap of $35,000 (unindexed) applies to individuals who are aged 49 years or over on 30 June of the previous financial year.

The Government is proposing to reduce the annual cap on concessional superannuation contributions to $25,000 for everyone, irrespective of their age.

Observations:

- The reduction in the CC cap will place limitations on additional super savings from salary sacrifice. For example, in 2017-18 an individual earning $200,000 would have 9.5% Super Guarantee contributions of $19,000 leaving only $6,000 available for salary sacrifice within the reduced cap.
- For individuals who were members of a funded defined benefit scheme as at 12 May 2009, the existing grandfathering arrangements will continue.

3. Reduction to Division 293 tax threshold

Proposed effective date: 1 July 2017

From 1 July 2017, the Government will lower the Division 293 threshold (the point at which high income earners pay additional 15% tax on contributions) from $300,000 to $250,000.

4. Allowing catch up concessional contributions

Proposed effective date: 1 July 2017

Currently, the concessional contribution cap is applied on a “use it or lose it” basis. That is, the unused amount of the concessional cap cannot be carried forward.

From 1 July 2017, the Government will allow eligible individuals to make additional concessional contributions where they have not reached their concessional contributions cap in previous years. This option will only be available to those individuals with a superannuation balance less than $500,000.

It is proposed that the unused amounts will be carried forward on a rolling basis for a period of five consecutive years with only unused amounts that accrue after 1 July 2017 being eligible.

The measure will also apply to members of defined benefit schemes. Consultation will be undertaken to minimise additional compliance impacts for these schemes.

Planning Points:

- This measure may assist people with interrupted work patterns (e.g. parents or carers) or those that have not been maximising their concessional contributions cap for other reasons.

5. Changes to concessional cap assessment for members of unfunded defined benefit schemes

Proposed effective date: 1 July 2017

The Government proposes to include notional (estimated) and actual employer contributions in the concessional contributions cap for members of unfunded defined benefit schemes and constitutionally protected funds. Members of these funds will have the opportunity to salary sacrifice similar to members of accumulation funds.

6. Removal of the work test to contribute to superannuation

Proposed effective date: 1 July 2017

Currently, individuals aged 65 to 75 who want to make voluntary superannuation contributions need to meet the work test. People aged 70 or over are also currently unable to receive contributions from their spouses.

The Government will remove these restrictions for all individuals aged less than 75, from 1 July 2017.

Planning Points:

- This measure will assist older people to contribute to superannuation. For example, this could involve contributing the proceeds from downsizing a family home or an inheritance.

7. Removal of the maximum earnings test to qualify for a tax deduction for a personal superannuation contribution

Proposed effective date: 1 July 2017

Currently, where a person is engaged in employment activities during a financial year, a deduction for personal superannuation contributions can only be claimed where the “less than 10% rule” is satisfied. This rule broadly requires that the income attributable to employment activities does not exceed 10% of income from all sources.

The Government is proposing to abolish this test, allowing all individuals up to age 75 to claim an income tax deduction for personal superannuation contributions. If legislated, this will effectively allow all individuals, regardless of their employment circumstances, to make concessional superannuation contributions up to the concessional cap.

Individuals who 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.

Observations:

- This measure assists those whose employer may not provide the ability to make salary sacrifice contributions to super. It will also assist those who are partially self-employed and partially wage and salary earners.

8. Introducing the Low Income Super Tax Offset

Proposed effective date: 1 July 2017

From 1 July 2012, individuals with an income of up to $37,000 automatically received a Government contribution of up to $500 paid directly into their super. However, this Low Income Superannuation Contribution (LISC) will not be available in respect of concessional contributions made after 1 July 2017.

From 1 July 2017, the Government is proposing to introduce a replacement - Low Income Superannuation Tax Offset (LISTO). The LISTO will provide a non-refundable tax offset to superannuation funds, based on the tax paid on concessional contributions made on behalf of low income earners, up to a cap of $500.

The LISTO will apply to members with adjusted taxable income up to $37,000 who have had a concessional contribution made on their behalf.

9. Making spouse contributions more attractive

Proposed effective date: 1 July 2017

Currently, an individual making a contribution into their spouse's account is entitled to a tax offset of up to $540 if certain requirements are met. One of the requirements to qualify for the maximum offset is that the receiving spouse's assessable income, reportable employer superannuation contributions and reportable fringe benefits in the financial year must be less than $10,800.

To be eligible to receive the contribution, the receiving spouse must currently be:

- under age 65 or
- aged between 65 and 70 and has met the work test for the financial year in which the contribution is made.

The Government proposes to:

- remove the work-test restrictions for all individuals aged up to 75 and
- increase access to the spouse superannuation tax offset by raising the lower income threshold for the receiving spouse to $37,000 (cutting out at $40,000).

10. Changes to the taxation of Transition to Retirement (TTR) Income streams

Proposed effective date: 1 July 2017

The earnings on superannuation fund assets that support a pension are exempt from tax at fund level regardless of the age of the client or the condition of release used to start the pension.

This tax exemption, where the assets are supporting a TTR Income Stream, will no longer be available from 1 July 2017. This means that earnings on fund assets supporting a TTR after this date will be subject to the same maximum 15% tax rate applicable to an accumulation fund.

Further to this, an election can currently be made for tax purposes to allow certain superannuation income stream payments to be taxed as lump sums. This can result in tax advantages for certain people under age 60 who make this election. The Government is proposing to remove this opportunity

Planning Points:

- The TTR income swap strategy will still be of benefit for clients where the tax savings on additional concessional contributions (after considering contributions tax) are greater than the net income tax on pension payments. The overall benefit however will be reduced due to the fact that these fund earnings will now be taxed at the rate of up to 15%.
- This measure, in addition to the proposed reduction to the concessional contribution cap, may result in the income swap strategy becoming less attractive for some clients, in particular those under age 60.
- At this stage, it is unclear as to whether the removal of the lump sum taxation election discussed above will extend to income streams commenced under arrangements other than TTR.

11. Introduction of a $1.6 million superannuation transfer balance cap

Proposed effective date: 1 July 2017

From 1 July 2017, the Government is proposing to introduce a $1.6 million transfer balance cap. This cap will limit the total amount of accumulated superannuation benefits that an individual will be able to transfer into the retirement income phase. Subsequent earnings on pension balances will not form part of this cap.

Where an individual accumulates superannuation amounts in excess of $1.6 million, they will be able to maintain this excess amount in a superannuation accumulation account (where earnings will be taxed at the concessional rate of 15 per cent).

A tax on amounts that are transferred in excess of the $1.6 million cap (including earnings on these excess transferred amounts) will be applied, similar to the tax treatment that currently applies to excess non-concessional contributions.

Fund members who are already in the retirement income phase with balances above $1.6 million will be required to reduce their retirement balance to $1.6 million by 1 July 2017. These excess balance amounts may be converted to a superannuation accumulation account.

To broadly replicate the effect of the proposed $1.6 million transfer balance cap, pension payments over $100,000 per annum paid to members of unfunded defined benefit schemes and constitutionally protected funds providing defined pensions, will continue to be taxed at 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.

Observations:

- This may require significant system/reporting changes for the ATO and potentially superannuation product providers. Consultation will be undertaken on the implementation of this measure for members of both accumulation and defined benefits schemes.
- The Government has announced that the amount of cap space remaining for a member seeking to make more than one transfer into a retirement phase account will be determined by apportionment. However at this point in time we do not have any information on the specific methodology to be used.

12. Removal of anti-detriment deduction

Proposed effective date: 1 July 2017

From 1 July 2017, the Government has proposed to remove the anti-detriment deduction.

The so called anti-detriment payment (ADP) is a legacy of reforms to superannuation that started on 1 July 1988.

Broadly, the purpose of the payment is to compensate eligible beneficiaries of a fund member for the reduction in lump sum death benefits that occurs because of the 15 per cent tax on earnings and concessional (pre-tax) contributions from 1 July 1988.

The ADP effectively increases the superannuation lump sum death benefit available to beneficiaries (spouse and children) so as to negate the effect of the 15 per cent tax that has been paid while the deceased member's benefit was accumulating in the fund.

Observations:

- The Government has confirmed that lump sum death benefits to tax dependants will remain tax free.
- Clients who are still eligible to contribute to superannuation, and who are still within their relevant contribution cap, may wish to reconsider withdrawal and re-contribution strategies.
- This may increase the attractiveness of taking a superannuation death benefit as an income stream for eligible beneficiaries.
- SMSFs with anti-detriment reserves will need to consider what to do with those reserves.

Taxation – General

13. Changes to marginal tax rates

As speculated, a tax cut has been proposed at the current $80,000 taxable income threshold. As a result, marginal tax rates for resident taxpayers are proposed to change as follows:

2015-16		2016-17	
Income ($)	**Marginal tax rate (%)**	**Income ($)**	**Marginal tax rate (%)**
0 – 18,200	0	0 – 18,200	0
18,201 – 37,000	19	18,201 – 37,000	19
37,001 – 80,000	32.5	**37,001 – 87,000**	32.5
80,001 – 180,000	37	**87,001 - $180,000**	37
> 180,000	47	> 180,000	47

Notes: Medicare levy may also apply, 47% tax rate includes Temporary Budget Repair Levy (TBRL, additional 2%). The TBRL is due to expire from 30 June 2017 and has not been extended in this budget.

Observations:

- The Low Income Tax Offset (LITO) remains unchanged which gives resident taxpayers an effective tax free threshold of $20,542 in 2016-17.
- Indicative tax cuts: A taxpayer earning $87,000 or more per year would get a maximum tax cut of $315 under this measure. A taxpayer earning less than $80,000 will have no change to their tax calculation.

14. Indexation of Medicare levy low income thresholds

Taxpayers with a low level of taxable income are not liable for the Medicare levy or pay a reduced rate as per the following table for the 2015-16 year:

Taxpayer	No levy payable when taxable income less than:	Reduced levy when taxable income between:	Ordinary rate of levy payable when taxable income exceeds:
Individual	$21,335	$21,336 - $26,668	$26,669
Individual eligible for SAPTO	$33,738	$33,739 – 42,172	$42,173
Family eligible for SAPTO	$46,966	$46,967 - $58,707	$58,708
Families with children/students			
0	$36,001	$36,002 - $45,001	$45,002
1	$39,307	$39,308 - $49,133	$49,134
2	$42,613	$42,614 - $53,266	$53,267
3	$45,919	$45,920 - $57,398	$57,399

The reduced level of Medicare levy is 10% of the taxable income that exceeds the low threshold. The full rate of Medicare levy is 2% of an individual's taxable income, subject to the above thresholds (2015-16 and 2016-17).

SAPTO is the Senior Australians and Pensioners Tax Offset which is available to those who are age pension age as at 30 June of the relevant year.

15. Pausing indexation of Medicare levy surcharge and private health insurance rebate

The Government proposes to extend the current pause on income threshold indexation for the Medicare levy surcharge and private health insurance rebate for a further three years from 1 July 2018.

The Medicare levy surcharge applies to taxpayers with income above certain levels who do not have a minimum level of private hospital cover.

Income thresholds and Medicare levy surcharge rates for 2015-16:

	Income	Tier 1	Tier 2	Tier 3
Singles	≤ $90,000	$90,001 - $105,000	$105,001 - $140,000	> $140,000
Families	≤ $180,000	$180,001 - $210,000	$210,001 - $280,000	> $280,000
Medicare levy surcharge rate	0%	1%	1.25%	1.5%

Income for the Medicare levy surcharge purposes includes taxable income, reportable fringe benefits, reportable superannuation contributions, add back of financial losses (e.g. negative gearing losses), certain family trust distributions and certain exempt foreign employment income.

Private health insurance rebate

	Income	Tier 1	Tier 2	Tier 3
Singles	≤ $90,000	$90,001 - $105,000	$105,001 - $140,000	> $140,000
Families	≤ $180,000	$180,001 - $210,000	$210,001 - $280,000	> $280,000
Age	Rebate for premiums paid, 1 April 2016 – 30 June 2016			
< 65 years	26.791%	17.861%	8.930%	0%
65 – 69 years	31.256%	22.326%	13.395%	0%
≥ 70 years	35.722%	26.791%	17.861%	0%

Rebate percentages are automatically adjusted by the Department of Health on 1 April each year. The rebate adjustment factor is a percentage of the increase of the consumer price index and the average annual premium increase.

Taxation – Small business

16. Increase in small business entity turnover thresholds

Proposed effective date: 1 July 2016

Starting from 1 July 2016, the Government proposes to increase the small business annual aggregated turnover threshold from $2 million to $10 million for certain small business concessions.

From 1 July 2016 these small business concessions include:

- the lowering of the small business corporate tax rate (see below),
- for all businesses with annual aggregated turnover of less than $10 million simplified asset depreciation rules, including immediate tax deductibility for asset purchases costing less than $20,000 until 30 June 2017, and
- other tax concessions such as the extension of the FBT exemption for work-related portable electronic devices and the immediate deduction of professional expenses.

Observation:

- The current $2 million turnover threshold, or alternative $6 million net asset value test, will be retained for access to the small business Capital Gains Tax concessions.

17. Lowering the company tax rate to 25 per cent

Proposed effective date: 1 July 2016

The Government proposes to reduce the company tax rate to 25 per cent by 2026-27.

Initially, the tax rate for companies with an annual aggregated turnover of less than $10 million will be reduced to 27.5 per cent from 1 July 2016.

Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

18. Unincorporated small business tax discount

Proposed effective date: 1 July 2016

For small businesses, that are not companies, the Government proposes to extend the unincorporated small business tax discount.

From 2016-17, the discount will be available to business with aggregated annual turnover of less than $5 million, up from the current threshold of $2 million. The discount on tax payable on business income will be increased to 8 per cent, up from the current 5 per cent, but the maximum discount available will remain at $1,000 per annum.

Over the next decade it is proposed to further expand the discount in phases to a final discount of 16 per cent, with the existing $1,000 maximum discount per individual for each income year to remain.

Families and Social Security

19. Deferral of reforms to child care payments

Proposed effective date: 1 July 2018

As part of the May 2015 Federal Budget it was proposed that a new single Child Care Subsidy (CCS) would replace the Child Care Benefit, the Child Care Rebate and the Jobs, Education and Training Child Care Fee Assistance from 1 July 2017.

This measure has not yet been legislated and it was announced that the proposed start date is now to be deferred until 1 July 2018.

Produced by TapIn