2016/17 FEDERAL BUDGET REPORT

FIN SEC PARTNERS

May 2016

For us, the big story out of Budget 2016 is of course Morrison's crackdown on high-end super tax concessions. Ten years on from Costello's tax-free super savings and now, on the other side of the resources boom, Morrison has redefined the purpose of super as a substitute or supplement to the welfare safety net of the aged pension, not a vehicle for wealth accumulation or bequests.

Whilst we welcome the fairness measures and in particular applaud those initiatives that help low-income earners and those with low superannuation balances, we do not look favourably on any announcement that proposes change retrospectively or that may be counterproductive to a person's ability to save for a secure and dignified retirement.

It has now been three weeks sice Budget night, but three eventful weeks in the context of understanding the motives and the landscape surrounding the proposals. We have heard from the various sides of the election campaign and now have a sense of what will go through and what might be 'retrospectively argued away'.

As is customary at FinSec, we have opted to wait and deliver a succinct report, focusing only on the information relevant to the financial advice we provide. As always, if you have questions relating to your personal circumstances, we encourage you to contact us so that we can discuss the proposed changes in greater detail.

But do not forget, at this stage the proposals are only announcements a lot may change as the legislation navigates both an election and the political process thereafter.

SUPERANNUATION

It has been some years since the Budget has included changes to the tax settings for superannuation in both number and significance as those forming part of the 2016 Budget. Indeed the proposed changes are the most significant changes to superannuation since the 'rules' were simplified in 2007.

Budget recommendations include:

1 Div 293 tax income threshold reduced

Proposed effective date: 1 July 2017

The Div 293 threshold (the point at which high income earners pay additional contributions tax) will be lowered from $300,000 to $250,000.

Currently anyone earning over $300,000 (for tax purposes) is subject to 30% tax on their concessional contributions. Under the new rule, those in the $250,000 to $300,000 tax bracket will join the party.
In our view, this is 'low-hanging fruit', an easy grab that we expect to see repeated in budgets of the future.
Individuals to be affected should the legislation be passed, is reported as less than 1% of Australians (budget.gov.au) and for these high income earners, 30% tax in super is still better than 45% out.
This measure is set to raise $2.5 billion over 4 years.

2 Reduction of the annual concessional contributions cap

Proposed effective date: 1 July 2017

The annual cap on concessional superannuation contributions will be reduced to $25,000 for all Australians irrespective of age.

The proposed annual cap will replace the existing cap which allows concessional contributions of $30,000 for those under age 50 and $35,000 for those aged 50 years and over.

As an attractive tax planning tool, this change will certainly decrease the value of superannuation. Advisers & Accountants will be left with the even harder task of finding alternative mediums within which to offset a client's income. 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.

Those on higher incomes will need to be extremely diligent to ensure their superannuation guarantee payments do not exceed the new cap.

For those nearing retirement it just got even harder to 'cash-up' your super. The introduction of the $25,000 for all, means that the cap applicable to over-50s is now (should the proposal be legislated) less than a quarter of what it was 10 years ago.

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

3 Removal of the work test to contribute to superannuation

Proposed effective date: 1 July 2017

People under the age of 75 will no longer have to satisfy a work test in order to make voluntary contributions to their superannuation. This includes receiving contributions from their spouse.

This proposal will replace the current rules whereby 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 spouse.

This measure removes the unfair complexities for those wanting to use super to increase their retirement savings over the age of 65. Under this rule anyone can contribute to super up until the age of 75 and can contribute from sources that may not have been available to them before retirement, including downsizing their home. Those under 75 years will also be able to receive contributions from their spouse under the contributions splitting rules (and presumably under the low-income spouse tax offset rules). A FinSec thumbs up on this one.

4 Restrictions on personal superannuation contribution deductions eased

Proposed effective date: 1 July 2017

All individuals up to age 75 will be allowed to claim an income tax deduction for personal superannuation contributions.

This proposal will replace the current rule, whereby if 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 benefits schemes, and any State, Territory or corporate defined benefit schemes that choose to be prescribed.

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.

5 Changes to concessional cap assessments for members of unfunded defined benefits schemes

Proposed effective date: 1 July 2017

The Government proposes to include notional (estimated) and actual employer contributions in the concessional contributions cap for member 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.

We welcome this proposal and recognise it as levelling the playing field.

6 Allowing catch up concessional contributions

Proposed effective date: 1 July 2017

Individuals with a superannuation balance less than $500,000 will be allowed to make additional concessional contributions where they have not reached their concessional contributions cap in previous years.

Amounts are carried forward on a rolling basis for a period of five consecutive years, and only unused amounts accrued from 1 July 2017 can be carried forward.

Catch up concessional contributions will replace the existing ‘use it or lose it’ rule where unused concessional caps can not be carried forward.

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

We understand the purpose of this measure and we like the spirit. Any initiative that encourages individuals to boost their superannuation payments (in particular those with interrupted work patterns or irregular capacity to make contributions, eg women or carers) gets a big tick in our book. But we do question the reality. How many Mothers returning to work have excess income with which to make additional super payments? We think it will be difficult for the average worker to take advantage of this one.

7 Lifetime cap for non-concessional superannuation contributions

Proposed effective date: 7.30pm (AEST) 3 May 2016

A lifetime non-concessional contributions cap of $500,000 will be introduced.

The lifetime cap will take into account all non-concessional contributions made on or after 1 July 2007. Meaning that contributions made between 1 July 2007 and 3 May 2016 will be counted towards this lifetime cap.

The proposed lifetime cap will replace the existing cap which currently allows annual non-concessional contributions of up to $180,000 per person, per financial year (or $540,000 every three years for individuals aged under 65 years).

Contributions made before commencement of this measure, that is 7.30pm (AEST) on 3 May 2016, will not be considered in excess.

Contributions made after commencement of this measure, that is 7.30pm (AEST) on 3 May 2016, will be considered in excess and will need to be removed or be subject to penalty tax.

The retrospective nature of this proposal has been widely documented. There is no doubt that for those approaching retirement, Mr Morrison has seriously compromised the ‘good faith’ in which their retirement plans have been made (using the strategy of the day). In particular; the ability for people to ‘wash away’ the taxable component of their super by recycling their contributions.

For super funds this will be no picnic either. The administration horrors associated with such a proposal begs the question, is it even a workable proposition?

We consider this measure a ‘super stinker’ (and it will only raise $550 million over 4 years). In our view it will most likely be ‘retrospectively argued away’.

8 Introduction of the Low Super Income Super Tax Offset (LISTO)

Proposed effective date: 1 July 2017

A low income superannuation tax offset (LISTO) will be introduced to reduce tax on superannuation contributions for low income earners from 1 July 2017.

The LISTO will replace the current Low Income Superannuation Contribution (LISC) scheme.

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.

9 Low Income Spouse Tax Offset Increased

Proposed effective date: 1 July 2017

The income threshold for the receiving spouse (whether married or de facto) of the low income spouse tax offset will be increased from $10,800 to $37,000.

This proposal will replace the currently legislation where to be eligible, the receiving spouse must:

- have assessable income, reportable employer superannuation contributions and reportable fringe benefits in the financial year of less than $10,800
- be under the age of 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 from $10,800 to $37,000 (cutting out at $40,000).

The measure will improve the superannuation balances of low income spouses by extending the current spouse tax offset to assist more families to support each other in accumulating superannuation. The low income spouse tax offset provides up to $540 per annum for the contributing spouse and builds on the governments co-contribution and superannuation splitting policies to boost retirement savings, particularly for women.

This measure will only cost $10 million over 4 years and gets a thumbs up from us.

10 Changes to the taxation of Transition to Retirement (TTR) income schemes

Proposed effective date: 1 July 2017

The tax exemption on earnings of assets supporting Transition to Retirement Income Streams (TRISs) will be removed from 1 July 2017, i.e. income streams of individuals over preservation age but not retired. (If you were born before 1 July 1960, then your preservation age is 55 years. If you were born on or after 1 July 1960, then your preservation age is at least 56 years and can be as old as 60 years. If you were born after June 1964, your preservation age is 60 years).

A rule that allows individuals to treat certain superannuation income stream payments as lump sums for tax purposes will also be removed.

This proposal replaces the current legislation where currently the internal earnings within a superannuation account on the amount used to purchase a pension are currently tax-free.

Effectively should this proposal be legislated earnings on fund assets supporting a transition to retirement income stream after 1 July 2017, will be subject to the same maximum 15 per cent tax rate applicable to an accumulation fund.

Existing strategy will need to be reviewed and forward planning will need to consider circumstances both inside and outside the system to ensure strategies optimise how the tax is applied.

We think it’s fair to say that the current TTR rules are ultimately a little too generous and probably needed to be addressed. There are still benefits to the strategy but they are limited. This proposal is inconvenient and unfair in it’s retrospectiveness, but not a bad call.

11 Introduction of a $1.6 mill Superannuation Transfer Balance Cap

Proposed effective date: 1 July 2017

A balance cap of $1.6m on the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase will be introduced from 1 July 2017.

Where an individual accumulates amounts in excess of $1.6m, they will be able to maintain this excess amount in an accumulation phase account (where earnings will be taxed at the concessional rate of 15%). Members already in the retirement phase with balances above $1.6m will be required to reduce their retirement balance to $1.6m by 1 July 2017. Excess balances for these members may be converted to superannuation accumulation phase accounts.

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

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. Commensurate treatment for members of defined benefits schemes will be achieved through changes to the tax arrangements for pension amounts over $100,000 from 1 July 2017. Consultation will be undertaken on the implementation of this measure for members of both accumulation and defined benefits schemes.

This is another proposal that is inconvenient and unfair in it's retrospectiveness. However, in our view not the disaster some media reports have made it out to be. Should this proposal be legislated we can work around this change and have in fact already 'stress tested' a number of scenarios to a positive outcome. This proposal will require further clarity for it to be effective, e.g. how is the cap managed in a market that fluctuates daily?

12 Removal of Anti-detriment Death Benefit Provision

Proposed effective date: 1 July 2017

The anti-detriment provision in respect of death benefits from superannuation will be removed from 1 July 2017.

The anti-detriment provision can effectively result in a refund of a members lifetime superannuation contributions tax payments into an estate, where the beneficiary is the dependant of the member (spouse, former spouse or child). Currently, this provision is inconsistently applied by superannuation funds.

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. Lump sum death benefits to dependants will remain tax free.

The no anti detriment is an easy one for the government. No one really understands it and so it does most of it's flying 'under the radar'. But, combined with the limit on the NCCs which effectively removes the opportunity to "wash out" super death taxes, it could prove pure genius as there will be plenty of people who end up paying more tax on death through lack of understanding. This could possibly provide a big windfall over time for the Treasury. Expect to see more from us on this topic soon.

We'd love to hear from you and are always here to answer your questions. If you have any concerns about how our news items may directly affect you, please call and have a chat with us, or make a time to come into the office.

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