2017/18 FEDERAL BUDGET REPORT

FIN SEC PARTNERS

May 2017

The Budget has dominated the headlines this past week. In short, despite the wailings of the media, it's a 'Storm in a Teacup' budget. Bit of extra spending here, a few more tax increases there, the continued promise of an imminent return to surplus and political opportunism at its core.

Many of you will have read the facts and figures by now, and have an understanding of the changes. This summary is not a simple reiteration of these facts.

As is customary we try to go one step further and explain what we see as the key changes relevant to our clients. Essentially, this summary represents our view.

We trust that you enjoy reading, and we look forward to speaking with you individually about how this budget may impact your personal circumstances.

SUPERANNUATION

After making significant changes to superannuation in the 2016 budget, the Federal Government has largely left superannuation untouched in 2017. Of course, the industry is still digesting and implementing the 2016 changes, most of which don't take effect until 1 July this year. Under these circumstances, only limited changes to Superannuation have been announced.

Budget recommendations include:

1 Introduction of a first home super saver scheme

Proposed effective date: 1 July 2017

From 1 July 2017, home ownership will be encouraged by allowing future voluntary contributions to superannuation made by first home buyers to be withdrawn (from 1 July 2018 onwards) for a first home deposit, along with associated earnings.

The amount of earnings that can be released is not related to fund earnings but instead will be calculated using a deemed rate of return based on a 90 day bank bill rate plus 3 percentage points.

Voluntary contributions can be either non-concessional (after tax) contributions or concessional (pre-tax) contributions, such as those through salary sacrifice arrangements. Importantly, compulsory superannuation guarantee contributions cannot be accessed under this scheme.

Concessional contributions and earnings that are withdrawn will be taxed at the individual's marginal rate less a 30 per cent tax offset. Combined with the existing concessional tax treatment of contributions and earnings, this will provide an incentive that will enable first home buyers to build savings more quickly for a home deposit.

Under the measure up to $15,000 per year and $30,000 in total can be contributed, within existing caps. Both members of a couple can take advantage of this measure to buy their first home together.

What does this mean for you?
For most first home buyers, the First Home Super Saver Scheme could boost the savings you can put towards a deposit by at least 30%, compared with saving through a standard deposit account.

Our view
We hope this measure will encourage younger investors to engage with their superannuation, understand it's effectiveness as a long-term wealth creation tool and how to invest to get the most out of it. The consequences of improving financial literacy in this area will have a positive 'knock-on effect' that can not be faulted.

Administratively speaking this measure will be no picnic for retirement funds who will now need to make assumptions about the length of time over which extra contributions are likely to be invested and ensure they have sufficient liquid assets to cover the withdrawals.

While on the surface the scheme will certainly help would-be home owners to save money, our analysis suggests that the benefit to the average wage earner will be minimal. $30,000 (the total that can be contributed) will not make much of a dent in a home deposit, particularly Melbourne and Sydney where housing 'un-affordabilility' is most severe.

There is also the added risk that super guarantee contributions could be used to fund the deposit. Our interpretation of the information provided so far indicates that if markets were to contract then members will still be able to withdraw their $30,000 plus deemed earnings, which could eat into their super contributions.

2 Incentives for older Australians to downsize their home

Proposed effective date: 1 July 2018

From 1 July 2018, a person aged 65 or over will be able to make a non-concessional contribution of up to $300,000 from the proceeds of selling their home. These contributions will be in addition to those currently permitted under existing rules and caps.

Importantly, the work test requirements that currently apply to persons aged 65 or older will not apply to these contributions, and they can also be made by those with more than $1.6 million of total superannuation.

The measure will apply separately for each member of a couple, In order to access this measure, the house must have been owned for at least 10 years.

What does this mean for you?
For those over 65years and looking to downsize you will be able to contribute up to $600,000 (jointly if a couple) of sale proceeds into superannuation regardless of caps or work test rules. However, it is important to note that in-line with current rules any changes in your super balance will count towards your Age Pension assets or income means test.

This measure has the potential to allow for top-ups to existing superannuation balances, and for those that may not have had the opportunity over their working life, will effectively be given a 'super' second chance to build their superannuation balance.

Our view

"We are all selfish and I no more trust myself than others with a good motive." Lord Byron

Case in point:
Retirees Mr and Mrs Kettle live in the family home, 20km's from Sydney's CBD precinct. The house is worth around 2 million dollars - modest by Sydney standards. They have no other assets and consequently are in receipt of $34,252 p.a. of Age Pension from Centrelink.

Under the new rules they decide to sell and downsize to a small 3 bedroom unit worth $1.3 million, investing $300,000 each to super to take a tax free pension.

Mr and Mrs Kettle are very happy, this move gives them the collective ability to generate an extra $30,000 p.a. in income, that is until they realise they have just moved $600,000 from their Centrelink exempt home into an assessable asset, meaning their Centrelink Pension has now reduced by half - But still they have more disposable income than they did before, so all things considered they are pleased.

For the government its high fives all round. Mr and Mrs Kettle's home has been released to the market to improve stock, their capacity to spend has increased which will have a snowballing affect on the economy and the Government now owes them $17,000 less per year in Age Pension payments.

And that's what we call genius politics!

Of all the measures this is the one that has peaked the attention of the FinSec team - not just for 'Morrison's motive', but for the many questions that spring to mind:

- Will downsizing include rental properties, another farm, at children's residence, or an aged care place?
- Will there be an age limit? For example can we down size at age 100 in the last year of our life?

No doubt the answers will be revealed as we review the 'succinct and simple' 900 pages of detailed legislation, regulations and commissioners rulings and guidelines...

3 Borrowing arrangements within super to impact new super rules

Proposed effective date: 1 July 2017

The Government has indicated concern that limited recourse borrowing arrangements (LRBA) used by SMSFs to invest in property can be used to circumvent contribution caps, effectively transferring growth in assets from the accumulation phase to the retirement phase and therefore not captured by the transfer balance cap. From 1 July 2017, the outstanding balance of a LRBA will now be included in a member's annual total superannuation balance and the repayment of the principal and interest of a LRBA, from a member's accumulation account, will be a credit in the member's transfer balance account.

What does this mean for you?
This measure is only applicable to people with Self Managed Super Funds and could affect their ability to make non-concessional contributions or carry forward any unused concessional contribution cap. Under this rule SMSF borrowings will now count towards your $1.6 million transfer balance cap and, $1.6million total superannuation balance.

It should also be noted that in draft legislation released prior to the budget, it was made very clear that this measure would not be retrospective, meaning arrangements in place prior to this change will not be impacted other than existing loans that are re-financed. However the budget papers were not entirely clear on this point and we seek further clarification on this issue.

FIN SEC PARTNERS

4 Integrity of non-arm's length arrangements

Proposed effective date: 1 July 2018

Affects those who have related party transactions in their SMSFs.

The Government will reduce the opportunities for members to use related party transactions on non-commercial terms to increase super savings. The non-arm's length income provisions will be amended to ensure expenses that would normally apply in a commercial transaction are included when considering whether the transaction is on a commercial basis.

5 Deferral of Future Fund withdrawals

Proposed effective date: drawdowns deferred by 12 months to now commence in 2021/22

The Future Fund was established in 2006 with funds being set aside to, amongst other things, ensure that a number of unfunded government superannuation schemes would have sufficient funds available to commence paying member benefits as they became due.

The Government has decided to defer by 12 months (at a minimum) the time at which amounts could first be accessed from the Future Fund until the year commencing 1 July 2021. The Government has indicated they will continue to monitor the need for future withdrawals from this fund and may look to introduce further deferrals in the future.

Our view

Similar to a worker delaying retirement and not drawing a retirement income from their superannuation savings, delaying the commencement of drawdowns from the Future Fund is expected to improve the likelihood of the Future Fund assets being sufficient to cover the future superannuation liabilities of public servants.

Importantly this measure should not be viewed as a restriction of access to entitlements now or in the future.

6 Extending tax relief for merging superfunds

Proposed effective date: Extended from 30 June 2017 to 30 June 2020

Those who are members of a super fund that chooses to merge with another fund during the above period, the Government has provided tax relief for merging funds, which essentially has meant that there has been no realisation of underlying gains or losses on assets held by the merging funds.

This relief is important for members of those funds as it avoids the need to physically sell assets, or for account balances to be impacted by tax outcomes where super funds choose to merge with each other. This tax relief has seen a number of superannuation funds (particularly industry funds) merge over the last few years.

As there is currently a review underway into the efficiency and competitiveness of the Australian superannuation industry, the Government has extended this tax relief for another three years. This may lead to a further consolidation of superannuation funds into the future.

Our view

We hope this measure does not deter people from reviewing their current superannuation arrangements to ensure they are in the right fund for them - take control over your own superannuation, don't wait for mergers.

FIN SEC PARTNERS

AGE PENSION

7 Reinstatement of the Pensioner Concession Card

Proposed effective date: 1 July 2017

The Government will reinstate the Pensioner Concession Card for pensioners who lost their card as a result of losing their Age Pension entitlement following the changes to the pension assets test from 1 January 2017.

What does this mean for you?
This means more people will have access to state and territory based concessions that were withdrawn at the time the government introduced tighter assets test rules.

The pensioner concession card gives recipients discounts on essential goods and services like medicine, hearing services, public transport fares, vehicle registration and property rates.

Our view
The changes introduced in January this year impacted many of our clients and around 92,000 people Australia wide, with the assets test limit dropping from $793,750 to $542,500 for singles and from about $1.1 million to $816,000 for couples. This is a small but none-the-less nice win for pensioners and rectifies an unintended consequence of the Hockey Budget.

8 Increase in residency requirement for Age Pension and Disability Support Pensions

Proposed effective date: 1 July 2018

The Residency requirements to qualify for the Age Pension and Disability support pension will increase from 1 July 2018.

Individuals will be required to have 15 years of continuous Australian residency before being eligible to receive either payment, unless they have either;

- 10 years of continuous Australian residence, with five being during their working life, or
- 10 years of continuous Australian residence, without having received an activity tested income support payment for a cumulative period of five years.

Existing exemptions for Disability Support Pension (DSP) applicants who acquire their disability in Australia will still apply.

What does this mean for you?
As a result of these changes, those who wish to apply for age and disability support pension may have to wait longer periods to receive payments.

Our view
We believe the intent of this measure is to stop older migrants joining family in Australia based on the generosity of the Australian social security system. Anyone who legitimately migrates and either works in the Australian Economy for their last few year or is fully self-supporting initially is unlikely to be impacted by the changes.

It is important to remember, at this stage the proposals are only announcements. As we all know far to well, a lot can change as the legislation navigates the political process.

More pertinent now is the fact that we have significant changes coming in July 1 as a result of last year's budget, these remain our immediate focus.

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.

admin@finsecpartners.com.au

Any advice contained in this newsletter is general advice only and does not take into consideration the readers' personal circumstances. To avoid making a decision not appropriate to you, the content should not be relied upon or act as a substitute for receiving financial advice suitable to your circumstances. Any reference to the readers' actual circumstances is entirely coincidental. When considering a financial product please consider the Product Disclosure Statement.

FinSec Partners Pty Ltd (ABN 98 135 591 829), trading as FinSec Partners, is a Corporate Authorised Representative of Kaizen Wealth Pty Ltd (ABN 19 608 040 062 AFSL 480 797)