2018 Federal Budget round-up

The 2018 Federal Budget has been called 'unusual', 'odd', 'ambitious' and 'victimless' and while those terms may or may not be true there's no doubt it is a pre-election budget. There were a few significant proposals impacting financial advisers and their clients however a number of smaller changes, particularly around superannuation, pensioners and aged care will also require a tweaking of strategies for many clients.

The Government's proposed personal tax cuts, targeted at low to middle income earners, are slated to be delivered over a seven-year period, through a combination of tax rate threshold changes and tax offsets. Proposed measures targeting group insurance in superannuation may impact younger and low balance members, and potentially their parents or partner should an illness or injury occur after 1 July next year.

Business owners may benefit from an extension of the small business instant write-off provisions and the Government has further committed to its plan to reduce the corporate tax rate, however funding for regulatory compliance and enforcement has also been ramped up.

In the social security arena aged care is a main area of focus, with welcomed increased expenditure in home care and mental health. Pensioners also have improved strategy options on the horizon, including improvements to both the Pension Bonus and Loan schemes and a renewed focus on making annuities viable.

In our round-up we have focussed on measures we believe to be of particular interest to financial advisers and their clients. It is by no means exhaustive but aims to provide some initial thoughts around advice implications of some of the key announcements.

Note: The following measures are proposals only. The proposals are subject to change, and require the passage of legislation prior to implementation.

Superannuation

Work test exemption for recent retirees

Proposed to take effect: 1 July 2019

An exemption from the work test is proposed for people aged 65-74 with superannuation balances under $300,000, for the first year they are unable to meet the test (relevant year). The threshold will be tested at the start of the relevant financial year and members will be able to contribute, subject to contribution caps, even where the balance subsequently exceeds $300,000 in the relevant year.

Under the work test, those aged 65-74 may only make a voluntary non-concessional contributions (NCCs) to superannuation if they have worked a minimum of 40 hours within any 30 day period of the financial year.

Preliminary observations

This measure will allow greater flexibility for recent retirees who are transitioning into retirement. It also provides an opportunity to maximise the tax free component of a superannuation balance by taking a lump sum benefit and contributing up to $100,000 or to take advantage of unused concessional contribution (CC) cap space to contribute under the existing CC cap carry forward rules (effectively available 1 July 2019) during the relevant year.

Example

Jacob retires from the work-force on 25 June 2019 at age 67 after working full-time at the same employer for over 25 years.

On 3 July 2019, he receives his final payment from his employer which includes a significant amount of unused annual and long service leave entitlements. Jacob would like to add this to his superannuation balance in order to commence a pension.

As Jacob retired from the workforce in the 2018/19 financial year and the contribution that he intends to make is in the 2019/20 financial year, he is unable to meet the work test. The exemption allows Jacob the flexibility to contribute this amount without having to extend his retirement date to satisfy this requirement.

Three-yearly audit cycle for some self-managed superannuation funds (SMSFs)

Proposed to take effect: 1 July 2019

The annual audit requirement for SMSFs will change to a three-yearly requirement if the trustees of the SMSF have:

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

Preliminary observations

From 1 July 2014 the Australian Taxation Office (ATO) was afforded greater regulatory powers to address contraventions of the Superannuation Industry (Supervision) Act 1993 (SIS Act) by SMSF trustees and to enforce penalties.

This measure allows the ATO to focus on non-compliance while rewarding SMSF trustees who are consistently meeting their obligations by reducing their administration costs. This may have a significant financial impact over the long term to member balances within SMSFs given an average auditor fee of $694 in 2016[1].

Increasing maximum number of members in SMSFs and Small APRA Funds (SAFs)

Proposed to take effect: 1 July 2019

As previously announced, this measure will allow SMSFs and SAFs to have up to six members, an increase from the current maximum of four.

Preliminary observations

This is a welcome proposal that will provide greater flexibility for larger families in managing their superannuation. However an even greater emphasis on compliance will be required by SMSF trustees and their advisers, particularly in relation to the separation of assets (which in monetary terms, represented 24% of all reported contraventions up to 30 June 2017[1]), ownership of assets and decision making – given that up to six individuals may be involved. A review of trust deeds, voting rights, control and passing of control will all need to be addressed.

Integrity measure for deductions of personal superannuation contributions

Proposed to take effect: 1 July 2018

The ATO will receive $3.1 million to improve the integrity of the 'notice of intent' (NOI) process. To claim a tax deduction on personal NCCs the member must provide a valid 'NOI to claim a personal tax deduction' to the trustee of their superannuation fund. When valid, contributions covered by the NOI are altered from non-concessional to concessional, and therefore become assessable income of the fund (taxable at 15% after deductions). Currently individuals may receive personal tax deductions on personal contributions without submitting a valid NOI, resulting in contributions being treated incorrectly for tax in the fund.

The additional funding provided to the ATO will support the development of a new compliance model and debt collection activities. Income tax returns will be altered to include a tick box to confirm individuals have complied with the NOI requirements.

Preliminary observations

From 1 July 2017, eligibility to claim a tax deduction on NCCs was no longer restricted to taxpayers who were self-employed or received less than 10% of their assessable income as an employee. With an increased reliance on the NOI process, inconsistencies or errors may result in unnecessary tax penalties for individuals if contribution caps are incorrectly exceeded and incorrect treatment of contributions may not be identified immediately. This measure will help to alert taxpayers of their obligation to notify the fund and receive an acknowledgement in order for a personal tax deduction for superannuation contributions to be claimed.

Example

Deanna is 58, self-employed and has never contributed to a superannuation fund.

Wanting to take advantage of the superannuation environment she makes monthly payments by BPAY of $10,000 to her superannuation balance on the first of each month from 1 July 2017.

In August 2018, Deanna claims a tax deduction for $20,000 however she does not send a valid NOI to her superannuation fund.

Deanna continues the same process however increases the contribution amount to $15,000 per month for the 2018/19 and 2019/20 financial years.

Deanna's superannuation fund has not received an NOI for any financial year and has reported all contributions as non-concessional.

Total contributions reported by Deanna's superannuation fund in 2017/18 was $120,000 which inadvertently triggered the bring-forward rule allowing up to $180,000 in NCCs available until 30 June 2020.

Because Deanna increased the monthly amount to $15,000 the entire $180,000 was contributed in the 2018/19 financial year. Every contribution made within the 2019/20 is now in excess of her NCC cap.

Preventing inadvertent concessional cap breaches by certain employees

Proposed to take effect: 1 July 2018

Clients who earn more than $263,157 and have multiple employers will be able to opt out of superannuation guarantee (SG).

This measure will allow eligible individuals to avoid unintentionally breaching the $25,000 annual CC cap as a result of multiple compulsory SG contributions.

1. ATO - Self-managed superannuation funds: A statistical overview 2015-2016

Employees who use this measure could negotiate to receive additional income instead of the SG contributions from their employer.

Preliminary observations

This is a positive measure as it will provide flexibility and allow high income earners the ability to avoid excess concessional contributions.

Insurance in superannuation

Proposed to take effect: 1 July 2019

Group insurance within superannuation will move from a default framework to an opt-in for those members:

- with balances of less than $6,000
- under the age of 25 years, (impacting only new members from 1/7/2019), or
- whose accounts have not received a contribution in 13 months and are inactive.

The aim of this proposal is to prevent superannuation balances from being eroded by premiums that members may not need or may not be aware of. The Government stated it will consult publicly on ways in which the current policy settings could be improved to better balance the priorities of retirement savings and insurance cover within superannuation.

Preliminary observations

This measure will give existing superannuation members 14 months to decide whether they will opt-in to their existing cover, including life, TPD and income protection held within the fund. Trustees will need to communicate with members holding balances under $6,000 and those with 'inactive' accounts to ensure they are aware of the changes as these members will have their cover switched off on 1 July 2019 unless they actively opt-in.

Consultation on proposed legislation will be key, in order to refine details of the measure, define terms such as 'inactive', and to determine notification protocols. Insurers will need to work with trustees to alter arrangements and work out how group cover is implemented for members once they turn 25. An exposure draft Bill has been released with consultation period concluding on 29 May.

While acknowledging the resulting expected superannuation account balance improvements for these members, this measure, combined with other touted proposals such as capping insurance premiums in superannuation, worsening claims experience and the increasing supervisory levies (an extra $31.9 million over the next four years), may result in an overall detrimental impact to life insurance premium rates and to the already concerning under-insurance of working age Australians.

Advisers may wish to ensure clients are aware of the need for themselves, their partners or their working children to decide whether to opt-in, or not, and understand the implications of not having insurance - particularly for parents and partners of those members affected - as those members will be reliant on other sources should illness or injury occur and insurance is not in place.

Inactive low balance superannuation accounts

Proposed to take effect: From 1 July 2019

This measure requires the transfer of all superannuation accounts with balances below $6,000 to the ATO if the accounts have been inactive for a continuous period of 13 months (except for defined benefit interests).

The exposure draft Bill also enables the ATO to proactively pay balances held by the ATO into a member's active superannuation account, where the reunited balance would be greater than $6,000.

Preliminary observations

Advisers may wish to assist clients to actively consolidate their superannuation accounts to their fund of choice, and ensure that any required insurance coverage is not lost inadvertently – particularly where clients have since become uninsurable.

Cap on passive fees on low superannuation account balances and ban on exit fees

Included in the exposure draft Bill released 9 May, this measure introduces a 3% annual cap on passive fees charged by superannuation funds on accounts with balances below $6,000 and bans exit fees on all superannuation accounts, regardless of balance. Note that the definition of exit fee excludes buy-sell spreads and other actual disposal costs (eg brokerage, CGT).

Under the proposed provisions trustees will be prevented from charging administration and investment fees exceeding 1.5% of the balance of accounts with balances below $6,000 for the six month period immediately following the date on which the balance is calculated (envisaged 1 July and 31 December). Otherwise, there is no maximum amount of administration and investment fees that can be deducted. Operating standards can prescribe how the amount of the account balance is calculated.

Retirement income covenant

Proposed to take effect: Not specified

Superannuation trustees will be required to formulate a retirement income strategy to help members achieve their retirement income objectives.

The intention is to focus the industry on providing a higher standard of living for retirees.

The covenant will require trustees to offer Comprehensive Income Products for Retirement (CIPRs), which are products that provide individuals with income for life.

Further, providers of retirement income products will be required to report simplified, standardised metrics in product disclosure to assist client decision making.

Preliminary observations

The Government will be releasing a position paper for consultation on this measure shortly.

Personal taxation

Personal income tax plan

Proposed to take effect: From 1 July 2018 to 2024/25 onwards

The Government will introduce a seven year personal income tax plan that is scheduled to be delivered from 2018/19 to 2024/25 and later financial years.

The key changes relate to personal income tax bracket thresholds, a new Low and Middle Income Tax Offset (LMITO) and changes to the existing Low Income tax Offset (LITO).

Personal income tax bracket thresholds

Over a seven year period commencing from 2018/19, the thresholds for the personal income tax brackets will increase as shown in the table below:

Rate	2017/18 (current)	2018/19 to 2021/22	2022/23 to 2023/24	2024/25 onwards
Nil	$0 - $18,200	$0 - $18,200	$0 - $18,200	$0 - $18,200
19%	$18,201 - $37,000	$18,201 - $37,000	$18,201 - $41,000	$18,201 - $41,000
32.5%	$37,001 - $87,000	$37,001 - $90,000	$41,001 - $120,000	$41,001 - $200,000
37%	$87,001 - $180,000	$90,001 - $180,000	$120,001 - $180,000	N/A – tax bracket removed
45%	$180,000+	$180,000+	$180,000+	$200,000+

The key change for 2018/19 is the increase of the 32.5% personal income tax bracket from $87,000 to $90,000.

By 2024/25, the personal income tax brackets will be simplified to four brackets so the majority of taxpayers will be on a marginal tax rate of 32.5% or less.

Low and Middle Income Tax Offset

Low to middle income earners will pay less tax due to a new Low and Middle Income Tax Offset (LMITO). The LMITO is a non-refundable tax offset worth up to $530 pa and will be available from 2018/19 to 2021/22.

The offset will be in addition to the Low Income Tax Offset (LITO) and will be received as a lump sum on assessment after an individual lodges their tax return.

The following table summarises the amount of the LMITO that an individual may be entitled to receive:

Taxable income (TI)	Maximum offset
$0 - $37,000	Up to $200
$37,001 - $48,000	$200 + [(taxable income - $37,000) x 0.03]
$48,001 - $90,000	$530
$90,001 - $125,333	$530 - [(taxable income - $90,000) x 0.015]

Individuals who earn more than $125,333 pa will not be entitled to the LMITO.

Low Income Tax Offset

From 1 July 2022, the existing Low Income Tax Offset (LITO) will be increased to a maximum of $645 pa for individuals with taxable income of less than $37,000 pa.

The following table summarises the amount of the LITO that an individual may be entitled to receive:

2017/18 to 2021/22		2022/23 onwards	
Taxable income	Maximum offset	Taxable income	Maximum offset
$0 - $37,000	Up to $445	$0 - $37,000	Up to $645
$37,001 - $66,667	$445 – [(taxable income - $37,000) x 0.015]	$37,001 - $41,000	$645 – [(taxable income - $37,000) x 0.065]
N/A	N/A	$41,001 - $66,667	$385 – [(taxable income - $41,000) x 0.015]
$66,667+	Nil	$66,667+	Nil

The above table shows that from 2022/23, the LITO will phase out at 6.5% in the income range from $37,000 to $41,000, and at 1.5% thereafter. Individuals who earn more than $66,667 will not be entitled to the LITO.

Preliminary observations

The changes to the personal income tax bracket thresholds are made to counteract the impact of 'bracket creep' which is caused by inflationary impacts on wages. The threshold change in 2018/19 creates a small tax saving for individuals earning up to $87,000.

Medicare low income thresholds increased

Proposed to take effect: 1 July 2018

Low-income Medicare levy thresholds for singles, families, seniors and pensioners will increase to take account of movements in the Consumer Price Index (CPI). The current exemptions from the Medicare levy will remain in place.

The thresholds announced for 2017/18 are shown below.

No Medicare if taxable income is equal to or less than ($):	
Singles	21,980
Singles eligible for SAPTO	34,758
Families	37,089
Families eligible for SAPTO	48,385
Additional for each dependent child/student	3,406

Retaining the Medicare levy at two per cent

Proposed to take effect: 1 July 2019

The Medicare levy will remain unchanged at 2% of taxable income. The levy was proposed to increase to 2.5% from 1 July 2019, as announced in the 2017/18 Budget, to fund the National Disability Insurance Scheme.

Preliminary observations

As the Medicare levy will not be increasing, other tax rates that are linked to the top personal tax rate, such as the fringe benefits tax rate, will also not proceed.

Testamentary trusts – clarification of taxation for minors

Proposed to take effect: 1 July 2019

The law will be strengthened to ensure that the concessional tax rates available for minors receiving income from testamentary trusts is limited to income derived from assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets.

Preliminary observations

There is currently a lack of clarity in the law which has enabled some taxpayers to obtain the benefit of the lower tax rate by contributing assets unrelated to the deceased estate into a testamentary trust. This is an integrity measure to align the rules with the original intention of the provisions in s102AG(2)(a) of the ITAA36 and should have a minor impact.

Removal of capital gains discount at the trust level for managed investment trusts

Proposed to take effect: 1 July 2019

This measure will prevent Managed Investment Trusts (MITs) and Attribution MITs (AMITs) from applying the 50% capital gains discount at the trust level. It is another integrity measure, designed to ensure that MITs and AMITs operate as genuine flow-through tax vehicles, whereby income is taxed in the hands of investors as if they had invested directly. MITs and AMITs that derive a capital gain will still be able to distribute this income as a capital gain that can be discounted in the hands of the beneficiary.

Preliminary observations

This measure will prevent beneficiaries, including corporate entities, which are not entitled to the CGT discount in their own right, from getting a benefit from the CGT discount being applied at the trust level.

Deductions denied for vacant land

Proposed to take effect: 1 July 2019

Expenses associated with holding vacant land will no longer be tax deductible. This measure ensures that no deductions (such as interest costs) are claimed for vacant land that is not genuinely held for the purpose of earning assessable income.

Such expenses for land that was previously vacant will only become deductible when:

- construction is complete, approval for occupancy has been granted and the property is available for rent, or
- the land is used in carrying on a business.

Preliminary observations

Any denied deductions that would ordinarily be included in an asset's cost base (ie 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 will not be able to be included in the cost base of the asset for CGT purposes.

Business taxation

Extension of the small business instant asset write off

Proposed to take effect: 1 July 2018

The Government will extend the accelerated depreciation for small businesses by 12 months to 30 June 2019 for businesses with aggregated annual turnover less than $10 million.

Small businesses will be able to immediately deduct purchases of eligible assets costing less than $20,000 first

used or installed ready for use by 30 June 2019. Only a few assets are not eligible (such as horticultural plants and in-house software).

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the small business simplified depreciation pool (the pool) and depreciated at 15% in the first income year and 30% 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).

Social security

Increase to Pension Work Bonus

Proposed to take effect: 1 July 2019

The Pension Work Bonus encourages age pensioners to remain in the workforce by allowing them to keep more of their pension when they have earnings from working.

Currently, the first $250 of fortnightly employment income is not assessed and is not counted under the pension income test. Under the proposed changes, the bonus will increase from $250 to $300 per fortnight. This means that the first $300 of income from work each fortnight will not count towards the pension income test.

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

Eligibility for the Work Bonus will also be extended to pensioners who are self-employed.

Preliminary observations

The Work Bonus is in addition to the income free area under the pension income test. This allows a single pensioner with no other income to earn up to $468 pf (ie $168 income free area plus $300 Work Bonus limit) in employment income and receive the maximum age pension.

New means testing rules for lifetime retirement income products

Proposed to take effect: 1 July 2019

The Government will introduce new age pension means testing rules to encourage the development and take-up of lifetime retirement income products.

The aim of these new lifetime retirement income products is to provide retirees with more retirement income products to choose from and help retirees manage the risk of outliving their savings. Under the proposed rules:

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

Any existing lifetime retirement income products purchased before 1 July 2019 will be grandfathered.

Preliminary observations

As this measure provides clarity about the future means testing treatment of lifetime products, this may encourage the development of new retirement income stream products from product providers.

Extending eligibility to the Pension Loans Scheme

Proposed to take effect: 1 July 2019

The Pension Loans Scheme is a voluntary reverse equity mortgage provided by Centrelink that offers older Australians an income stream to supplement their retirement income.

Under current rules, the scheme allows clients to increase 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 increased payments are a loan secured against Australian real estate which can be repaid at any time or when the property is sold or the client passes away.

From 1 July 2019, the Pension Loan Scheme will be expanded by:

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

Preliminary observations

If this measure becomes law, maximum rate age pensioners will be able to increase their income by up to $11,799 (singles) or $17,787 (couples) pa.

Further, while the overall maximum amount clients can receive is 150% of the maximum rate of the age pension, the actual limit will depend on the client's age, how long they intend to receive payments, whether they are single or partnered, the value of their home and how much age pension they receive. These limitations ensures that clients do not have to pay back more than what their home is worth.

Aged care

Better access to aged care services

Proposed to take effect: 1 July 2018

Currently, more than 100,000 older Australians are on the national waiting list for a home care package.

As a result, the Government will provide an additional 14,000 new high level home care packages over the next four years from 2018/19. This increase is in addition to the 6,000 high level packages that were delivered in the 2017/18 Mid-Year Economic and Fiscal Outlook.

An extra 13,500 residential aged care places will also be provided in 2018/19.

Preliminary observations

The extra Government funding will help older clients remain independent and stay in their own home for longer rather than moving to residential aged care.

National online register of enduring powers of attorney

Proposed to take effect: Not specified

To protect older Australians from elder abuse, the Government plans on working with the States and Territories to develop a nationally consistent legal framework and establish a National Register of Enduring Powers of Attorney.

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