# 2016 Federal Budget round-up

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## TECE – Technical and Education Centre of Excellence

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As the first Budget in years to make significant amendments to superannuation, the 2016 Federal Budget proposes changes that will provide flexibility and reduce red tape in some areas, but introduces significant administrative change and complexity in others, (for example tracking lifetime pension balances and after tax contributions to super – recall RBLs anyone?).

Welcome tax relief for both incorporated business owners and the self-employed features heavily, as does infrastructure investment, and there is a renewed commitment to reducing tax avoidance and maintaining regulatory oversight.

From a financial planning and wealth protection point of view, the details of the measures – particularly around superannuation - will be key to understanding the impact on clients. The proposed timeframes will be challenging for advisers, clients and providers alike.

What is not in doubt, is that nearly every financial plan will need to be revisited and reworked should these changes go ahead.

Following is our round-up of some of the measures likely to impact individuals, small businesses and families, with some initial thoughts on the planning impacts and considerations for clients.

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

## Superannuation

### Concessional contributions cap reduces to $25,000

Proposed to take effect: 1 July 2017

The Government will reduce the annual cap on concessional (before tax) superannuation contributions to $25,000 (currently $30,000 under age 50 and $35,000 for ages 50 and over).

### Introduction of a lifetime cap for non-concessional superannuation contributions

Proposed to take effect: 1 July 2017

The Government will introduce a $500,000 lifetime limit on non-concessional contributions (NCCs or after tax contributions). The measure will retrospectively take into account all NCCs made on or after 1 July 2007, from which time the Australian Taxation Office has reliable contributions records, and will commence at 7.30 pm (AEST) on 3 May 2016. After tax contributions made before commencement cannot result in an excess. However, excess NCCs made after this date will need to be removed from super or be subject to penalty tax.

The lifetime NCC cap will replace the existing annual caps which allow annual NCCs of up to $180,000 per year (or $540,000 every three years for individuals aged under 65).

**Preliminary observations:** The proposed combination of a lower concessional contribution (CC) cap and a $500,000 lifetime NCC cap will impact current retirement projection models for clients. Therefore financial plans will need strategies to be revisited and projection outcomes remodelled, once the detail becomes clear. For example at this stage it is not known if the $500,000 lifetime cap will be indexed, how the rolling 5 year calculation will work, nor how withdrawals will impact this figure. Nor is it known whether legislation will mirror existing excess NCC provisions whereby clients can elect to 'release' excess taxable contributions notwithstanding the excess contribution stems from NCCs (the proportioning rule does not currently apply to these release authorities).

For those with insurance held through super, a $5,000 reduction in the concessional contributions (CC) cap is not likely to impact the majority of clients, however in relation to contribution rules overall, consideration will need to be given to those:

- on high incomes with significant Superannuation Guarantee payments being made on their behalf, as the maximum SG contribution base of around $200,000 per year does not leave much room to salary sacrifice additional contributions after 9.5% is paid)
- with other employer or deductible amounts counting towards CC caps such as salary sacrifice, employer funded insurance or employer paid expenses within their super fund
- paying a high level of insurance premiums into super, as retirement balances eroded by rising premiums will be harder to maintain through additional contributions
- looking to make significant contributions in the remainder of this financial year or next year – ensure clients check their position first and remember the NCC limit is to be counted back to 1 July 2007
- relying on injecting significant amounts to super using recycling strategies to improve tax outcomes, such as a recontribution strategy to reduce the impact of taxation on benefits to non-tax dependants, and
- clients relying on injecting significant amounts to super to provide liquidity on death or disablement of an SMSF member.

No mention of changes to the small business CGT retirement or personal injury contributions limits was made in the Budget papers.

## Introduction of 'catch-up' concessional superannuation contribution rule

Proposed to take effect: 1 July 2017

Individuals will be able to make additional concessional contributions where they have not reached their $25,000 CC cap in previous years. Access to unused CC cap amounts will be limited to those individuals with a superannuation balance of less than $500,000. Amounts will be able to be 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.

Annual CC caps can limit the ability of people with interrupted work patterns to accumulate superannuation balances commensurate with those who do not take breaks from the workforce. Allowing people to carry forward their unused concessional cap provides them with the opportunity to 'catch-up' if they have the capacity and choose to do so.

**Preliminary observations:** Cash flow permitting, and without having seen any detail around this measure, as proposed this measure provides scope to for all individuals with super account balances totalling less than $500,000, who are not contributing up to their CC cap, to 'replenish' their super. This will help to fund for retirement goals for those clients that do not have the cash flow to make deductible contributions in a particular year, or even just maintain account balances where their super is funding insurance premiums or perhaps suffering poor investment returns.

If introduced, strategic planning to time catch up CC contributions with years of high taxable income, such as in the year of the sale of a CGT asset, will improve taxation outcomes for clients.

## No superannuation contribution work test required between the ages of 65 and 74

Proposed to take effect: 1 July 2017

The Government proposes to remove the current restrictions on people age 65 to 74 from making superannuation contributions for their retirement. People under the age of 75 will no longer have to satisfy a work test and will be also be able to receive contributions from their spouse (currently limited to age 70 and dependant on the recipient spouse meeting the work test).

The objective of this measure is to simplify the superannuation system for older Australians and allow them to increase their retirement savings, especially from sources that may not have been available to them before retirement, including from downsizing their home.

**Preliminary observations:** This is a positive measure allowing increased scope for clients to fund their retirement goals once they have stopped working and are selling off assets and/or downsizing – subject to the revised CC cap and NCC lifetime limit.

Clients with insurance in super will be able to fund their insurance past age 65 by making contributions rather than having to move to a non-super policy or relying on accumulated account balances and rollover solutions.

Under current rules, equalising super balances between husband and wife after 65 is challenging due to the work test and super splitting being limited to only 85% of CCs. If implemented, the ability to make NCCs for a spouse over age 65 (coupled with the removal of the current NCC caps) provides some scope to 'equalise' super balances and in turn keep balances below the all-important $500,000 threshold for the catch up CC cap and/or keep under the $1.6 million pension limit. For example from 1 July 2017, if Spouse A has more than $1.6 million in their super pension account a forced withdrawal ensues. The excess could be withdrawn and recontributed into Spouse B's account where it can then be converted into pension phase (assuming spouse has NCC cap space at their disposal – no large NCCs since 2007).

In addition a surviving spouse that is over 65 but under 75 would be able to cash out and recontribute a late spouse's death benefit to save any tax payable by non-dependants on superannuation death benefits without having to meet the work test. Again though, this would only be of use to those clients that haven't utilised the revised $500,000 NCC cap since 2007.

## Removal of the 'less than 10% test'

Proposed to take effect: 1 July 2017

All individuals up to age 75 will be able to claim an income tax deduction for personal superannuation contributions. This measure removes the requirement that an individual be either 'unsupported' with regard to SG payments, or 'substantially self-employed' in order to claim a tax deduction for personal contributions to super. It allows all individuals, regardless of their employment circumstances, to claim a deduction for personal contributions to super up to the CC cap.

**Preliminary observations:** This is a significant and welcome proposal, notwithstanding the reduced CC cap of $25,000.

Individuals who are partially self-employed and partially wage and salary earners during an income year, and individuals whose employers do not offer salary sacrifice arrangements will particularly benefit from these changed arrangements. Under the current laws, these employees are not be able to claim personal deductible contributions if their SG qualifying employment income exceeds 10% of their total income from all sources.

The measure will also be useful for clients that have crystallised a capital gain at a later stage in the financial year where salary sacrificing wouldn't otherwise provide much scope to utilise the concessional cap.

The ability for clients to determine the amount of personal deductible contribution retrospectively, without having to rely on the prospective nature of a salary sacrifice agreement, might also be attractive. It may make super fund owned insurance more appealing for those clients that wouldn't have otherwise been entitled to make pre-tax contributions (due to failing the 10% test) or who want to contribute very specific CC contribution amounts to pure insurance superannuation policies.

## Eligibility for spouse contribution offset widened

Proposed to take effect: 1 July 2017

The Government will increase access to the low income spouse superannuation tax offset by raising the income threshold for the low income spouse to $37,000 from $10,800. The low income spouse tax offset provides up to $540 per annum for the contributing spouse and is subject to other qualifying criteria.

**Preliminary observations:** This measure would provide more incentive to make spouse contributions in order to meet spouse retirement goals, and will be especially important to address equalisation issues, especially in light of the limit on balances permitted to fund retirement phase for each individual.

Spouse contributions are also a tax-effective way to fund insurance premiums being deducted from a spouse's account and/or offset deterioration of a spouses superannuation balance due to insurance premiums.

## Introduction of a $1.6 million superannuation transfer balance cap

Proposed to take effect: 1 July 2017

A $1.6 million transfer balance cap will be imposed on the total amount of accumulated superannuation savings an individual can transfer into the retirement/pension phase. Subsequent earnings on these balances will not be restricted. This will limit the extent to which the tax-free benefits of retirement phase accounts can be utilised.

Where an individual accumulates amounts in excess of $1.6 million, 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 per cent).

Members already in the retirement phase with balances above $1.6 million will be required to reduce their retirement balance to $1.6 million by 1 July 2017. Excess balances for these members may be converted to superannuation accumulation phase accounts.

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

**Preliminary observations:** We require further detail on this measure to assess the full impact - will the limit be indexed, what happens with rollovers or pension refresh, and will reserving be possible? However there will certainly be negative consequences for many retirees, and financial plans focussing on retirement utilising superannuation pensions will need significant review.

Clients with multiple pension accounts will presumably have the choice as to which pension interest is to be 'wound back'. From an estate planning perspective it would make sense to wind back pension interest(s) that have a relatively higher taxable component. In other words, where possible clients should think about allocating/retaining tax free pension interests within this $1.6m cap as these pension interests, given their tax free status, are anticipated to appreciate at a faster rate than accumulation interests where 15% tax is being imposed.

Death and disability benefit pensions may also be impacted by this measure – we await the detail here – however this may see the other estate planning options such as distributing super inheritances via testamentary trusts gaining popularity.

## Retention of the a Low Income Superannuation Tax Offset (LISTO)

Proposed to take effect: 1 July 2017

The effect of the current low income super contribution (due to cease from 1 July 2017) will be maintained by introducing a Low Income Superannuation Tax Offset (LISTO) to reduce tax on superannuation contributions for low income earners. The LISTO will provide a non-refundable tax offset to superannuation funds, based on the tax paid on CCs made on behalf of low income earners, up to a cap of $500. Provision will be made to ensure the measure can be implemented to achieve the outcomes as intended. The LISTO will apply to members with adjusted taxable income up to $37,000 that have had a CC made on their behalf.

**Preliminary observations:** This will effectively avoid the situation in which low income earners would pay more tax on savings placed into superannuation than on income earned outside of superannuation and support retirement funding and/or insurance in super strategies for these individuals.

## 30% super contributions tax threshold lowered to $250,000

Proposed to take effect: 1 July 2017

The Government intends to lower the Division 293 threshold (the point at which high income earners pay addition contributions tax) from $300,000 to $250,000.

Very broadly, deductible contributions to super (CCs) by individuals earning above the threshold are subject to an additional 15% tax on top of the 15% standard contribution tax rate.

**Preliminary observations:** If insurance is held inside a super fund, then technically those earning over $250,000 still only pay 15% contributions tax once the insurance premium tax deduction, offsetting the ordinary 15% contributions tax, is taken into account. The AIA TECE team will provide more information about this strategy in a future TECE Update.

## Removal of the anti-detriment provision

Proposed to take effect: 1 July 2017

The current anti-detriment payment available on certain death benefits will be removed.

The anti-detriment provision can effectively result in a refund of a member's lifetime superannuation contributions tax payments into their superannuation account for payment as a lump sum death benefit, where the beneficiary is the dependant of the member (spouse, former spouse or child). Currently, this provision is inconsistently applied by superannuation funds as it is not compulsory and can be challenging to fund, particularly for SMSFs.

**Preliminary observations:** It should be noted that an anti-detriment amount as it stands is not payable on the insurance component of a death benefit, nor is it payable on a death benefit paid as a pension. The removal of this provision will however impact lump death benefits to certain beneficiaries and effectively even the playing field in this respect between the various types of funds in the market. In addition, from 1/7/17, we no longer have the recontribution versus anti-detriment conundrum/trade off.

Interestingly, it appears the future liability deduction will remain for SMSFs – potentially a very tax effective provision for funds to claim a tax deduction on a certain proportion of a death or disability lump sum or pension (including insurance proceeds) in respect of a member under 65 and ceasing work due to the event.

## Tightening the transition to retirement regime

Proposed to take effect: 1 July 2017

The Government will remove the tax exemption on earnings of assets supporting Transition to Retirement Income Streams (TRIS) from 1 July 2017 (income streams of individuals over preservation age but not retired). It will also remove a rule that allows individuals to treat certain superannuation income stream payments as lump sums for tax purposes.

**Preliminary observations:** More detail is required in relation to this measure but generally speaking, it was unexpected and is likely to negatively impact many retirees and require adjustment to clients' financial plans who were relying on TRIS to either boost their retirement savings or fund a true transition to retirement.

This proposal may well result in a rush for clients to commence a TRIS in the lead up to July 2017, and thought should be put into whether this would be a sensible strategy for clients, given that the growth component is locked in. However many questions still remain such as whether clients will still be able to make a lump sum election before 1 July 2017 to reduce tax on payment under age 60. It certainly will make a TRIS prior to age 60 less compelling, unless the client has a high percentage of tax free component.

## Other taxation measures

### Targeted personal income tax relief

The 32.5% personal income tax threshold will increase from $80,000 to $87,000 from 1 July 2016.

This measure will reduce the marginal rate of tax on incomes between $80,000 and $87,000 from 37% to 32.5% and is intended to address bracket creep for this group of income earners.

### Ten Year Enterprise Tax Plan — reducing the company tax rate to 25%

The company tax rate will reduce to 25% over 10 years.

The tax rate for businesses with an annual aggregated turnover of less than $10.0 million will be 27.5% from the 2016-17 income year. The threshold will then be progressively increased to ultimately have all companies at 27.5% in the 2023-24 income year.

The annual aggregated turnover thresholds for companies facing a tax rate of 27.5% will be:

- $25.0 million in the 2017-18 income year;
- $50.0 million in the 2018-19 income year;
- $100.0 million in the 2019-20 income year;
- $250.0 million in the 2020-21 income year;
- $500.0 million in the 2021-22 income year; and
- $1 billion in the 2022-23 income year.

In the 2024-25 income year the company tax rate will be reduced to 27% and then be reduced progressively by 1% per year until it reaches 25% in the 2026-27 income year. Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

## Ten Year Enterprise Tax Plan — increase the unincorporated small business tax discount

The tax discount for unincorporated small businesses will be increased over 10 years from 5% to 16%. The tax discount will increase to 8% on 1 July 2016, then increase to 10% in 2024-25, 13% in 2025-26 and reach a permanent discount of 16% in 2026-27. This will coincide with staggered cuts in the corporate tax rate to 25%, as outlined above. The current cap of $1,000 per individual for each income year will be retained.

The tax discount applies to the income tax payable on the business income received from an unincorporated small business entity. Access to the discount will be extended to individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than $5 million.