2016 Hub Wealth Management Federal Budget Summary

On the 3rd of May 2016, Treasurer Scott Morrison released the Federal Government's 2016/17 Budget. This summary focuses on the impact of the budget on you, with particular interest in areas such as personal tax, superannuation and pension strategies. Most importantly, **all of the measures announced are proposals only** and may or may not become law.

Some Strategic Issues For Consideration

Assuming that these measures come into effect, there will be a variety of strategic issues for different individuals and circumstances. In each instance, **we will discuss the issues and options you personally.** Some examples include:

- People with account-based pensions over $1,600,000 will need to update their approach, including potentially rolling some money back to superannuation accumulation phase;

- People who have not used their full concessional contribution cap in 2015/16 may wish to do so, as the cap reduces from 1 July;

- The introduction of the "catch up" regime for concessional contributions for people with balances below $500,000 may offer some opportunities in future years;

- People aged 65-74 from 1 July 2017 will be able to contribute to super without a work test to make concessional, non-concessional of a combination of contributions. This offers real flexibility, and the opportunity to increase the use of super/pension strategies for some people. It is also a means to reduce tax for those with assessable income over $18,200;

- People with Transition to Retirement Pensions will need to re-evaluate the logic and impact of those strategies, as account earnings will be taxed at the superannuation rate from July 2017;

Things That Remain The Same

There is no change to the following key items:

- Earnings in account-based pension earnings are tax-free, and pension payments or withdrawals made after age 60 are also tax-free;
- The ability to access superannuation withdrawals tax-free after age 60;
- Tax of earnings in superannuation accumulation phase remains at a maximum rate of 15%;
- Rules for capital gains tax and negative gearing;
- Personal tax rates see only a very minor change.

HUB WEALTH MANAGEMENT

Summary

Date of effect: Immediate

- A lifetime cap on non-concessional (after-tax) superannuation contributions of $500,000 will apply from 7.30 pm on 3 May 2016. This includes all non-concessional contributions made since 1 July 2007.

Date of effect: 1 July 2016

- The income tax threshold at which the 37% tax applies will increase to $87,001 pa, from the current $80,001 pa.
- The tax rate that applies to small business companies will reduce to 27.5% for businesses with a turnover up to $10 million in 2016/17. Further tax concessions will apply in future years.

Date of effect: 1 July 2017

- The annual cap on concessional (pre-tax) super contributions will reduce to $25,000, regardless of age.
- Concessional super contributions may exceed the annual cap if certain conditions are met.
- Those aged between 65 and 74 will be able to make super contributions regardless of whether they work or not.
- Tax deductions can be claimed for personal contributions regardless of employment status.
- A lifetime limit of $1.6m will be placed on the amount of superannuation that can be transferred to start pensions.
- Earnings in 'transition to retirement' pensions will be taxed at 15% (currently 0%).

Measures not announced or affected

- Negative gearing
- Age pension and other social security benefits

Superannuation

Objective of Superannuation

The Government announced that it will enshrine in legislation the objective of superannuation as "*to provide income in retirement to substitute or supplement the Age Pension*". This objective has guided the reforms announced, and the Government believes it will enhance future stability in the superannuation system.

Retirement Income Streams

These are primarily account-based pensions and annuities currently. The Government announced it will remove barriers to innovation in this area by extending the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities.

The review of retirement income stream regulation (released with the budget) states that current annual minimum drawdown limits are consistent with the objective of the superannuation system to provide income in retirement. However, the review also proposed that the Australian Government Actuary should review the annual minimum drawdown rates every five years to ensure they remain appropriate in light of increasing life expectancies. Any other changes to minimum drawdown rates should only be considered if there is a significant economic shock.

Changes effective 1 July 2017

The following superannuation reforms are proposed to apply from 1 July 2017.

Cap on concessional contributions

The annual cap on concessional super contributions will reduce to $25,000, regardless of age. This change will reduce the amount of concessional contributions that can be made each year without a tax penalty. There will, however, also be the opportunity for certain people to contribute more if they haven't fully utilised the cap in previous financial years—see below.

Concessional contributions include:

- salary sacrifice
- superannuation guarantee
- personal contributions claimed as a tax deduction, and
- certain other amounts.

Currently the cap on concessional contributions depends on age—see table on the following page.

Table 1: Concessional contribution caps		
Age	**Annual cap amount**	
	In 2015/16 and 2016/17	**From 2017/18**
48 or under	$30,000	$25,000
49 or over	$35,000	$25,000

Additional tax on concessional contributions for those earning over $250,000 p.a.

Broadly, an additional 15% tax on concessional contributions will be payable by those earning more than $250,000 pa. Currently this additional tax, which is payable on top of the standard maximum tax rate of 15% on concessional contributions, only applies to those *earning more than $300,000 pa.*

Table 2: Tax on concessional contributions		
Income[1]	**Tax on concessional contributions made within the cap**	
	In 2015/16 and 2016/17	**From 2017/18**
<$250,000	15%	15%
$250,000 to $300,000	15%	30%
$300,000+	30%	30%

'Catch-up' concessional contributions

Concessional super contributions may exceed the annual cap if:

- the annual cap in previous financial years is not fully utilised, and
- the superannuation balance is less than $500,000.

Only cap amounts unused from 1 July 2017 can be carried forward for up to five years.

This measure aims to help eligible individuals who have not been able to utilise the caps due to broken work patterns or competing financial commitments, to make additional or 'catch-up' super contributions.

Contributions between ages 65 and 74

Those aged between 65 and 74 will be able to make super contributions regardless of whether they work or not. Currently, the "work test" requires people in this age bracket to work 40 hours in 30 days in the relevant financial year to make super contributions.

HUB WEALTH MANAGEMENT

Tax deduction for super contributions

Tax deductions will be able to be claimed for personal contributions regardless of employment status. Currently only self-employed people (e.g. sole traders) and those who earn less than 10% of total income from employment sources are eligible to claim a tax deduction.

Extending the spouse contributions offset

From 1 July 2017, the 18% tax offset of up to $540 will be available for any individual contributing to a spouse's superannuation whose income is up to $37,000. This compares to the current rule, where the recipient spouse income can be a maximum of $10,800.

The tax offset will be calculated as 18% of the lesser of:

- $3,000 reduced by every dollar over $37,000; or
- The amount of spouse contributions.

Low income Superannuation Tax Offset (LISTO)

From 1 July 2017, a Low Income Superannuation Tax Offset (LISTO) will be introduced to replace the existing Low Income Superannuation Contribution. 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 that have had a concessional superannuation contribution made on their behalf.

Removal of anti-detriment payments

From 1 July 2017, superannuation funds will no longer be able to make anti-detriment payments.

The anti-detriment payment provision allows superannuation funds to refund a lump sum to a member's estate on death, in compensation for the 15% tax deducted on concessional contributions. This "anti-detriment" payment effectively adds to the superannuation death benefit if there are dependants.

Superannuation pension limits

A lifetime limit of $1,600,000 will be placed on the amount of superannuation that can be transferred to start pensions. This limit will be called the 'transfer balance cap'.

Earnings on investments held in pensions (other than transition to retirement pensions—see below) will continue to be taxed at 0%. Earnings on any balance that needs to remain in superannuation will continue to be taxed at up to 15%.

People with existing pensions over $1.6 million will need to reduce the balance below this limit by 1 July 2017 to avoid penalties.

Transition to retirement pensions

Earnings on investments held in 'transition to retirement' pensions will be taxed at 15% (currently 0%). A transition to retirement pension is a pension that is started with superannuation money when you have reached your preservation age, which is between 55 and 60 depending on date of birth. Once permanently retired (or another condition of release is met), it is expected that the underlying earnings will then be taxed at 0%.

Changes effective immediately

Changes to non-concessional contributions

A **lifetime non-concessional contribution (NCC) cap of $500,000** will apply from 7.30 pm on 3 May 2016. All NCCs made on or after 1 July 2007 will count towards this lifetime cap.

NCCs include personal contributions made where no tax deduction is claimed, contributions made on behalf of a spouse and certain other amounts.

Any contributions made after commencement exceeding the lifetime limit (as well as assumed earnings on these amounts), will be subject to penalty tax if not withdrawn.

These measures will replace the current NCC cap of $180,000 pa, or $540,000 over a three year period if certain conditions are met.

Taxation

Personal tax rate changes

Date of effect: 1 July 2016

The income tax threshold at which the 37% tax applies will increase to $87,001 pa, from the current $80,001 pa. There are no other changes to marginal tax rates. Individual taxpayers with an income below the new threshold will not receive any tax cut. Those currently receiving above $80,000 pa will receive a tax saving. The maximum tax saving is $315 pa.

Table 3: Comparison of tax rates and thresholds

Current tax thresholds 2015/16	Tax rate	New tax thresholds 2016/17	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+	45%	$180,000+	45%

A person with income of $87,000 p.a. and above will save $315 in a full financial year.

Note: These tax rates do not include the Medicare levy and Temporary Budget Repair Levy

Budget Repair Levy

Date of effect: 1 July 2017

On 30 June 2017, the three-year Temporary Budget Repair Levy on high income individuals will cease. Up until then, the Temporary Levy will continue to apply at the rate of 2% on individuals' taxable income in excess of $180,000 pa. This effectively means that the top marginal tax rate will reduce from 49% to 47% (including Medicare Levy) from 1 July 2017. The Labor Party has already indicated that they are against this measure.

Company tax rate

Date of effect: 1 July 2016 and beyond

The tax rate that applies to small business companies will reduce to 27.5% for businesses with a turnover up to $10 million in 2016/17 and will be extended to larger business thereafter.

Table 5: Maximum business turnover to be eligible for 27.5% company rate							
Tax year	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Turn over	$10m	$25m	$50m	$100m	$250m	$500m	$1b

From 1 July 2024, the company tax rate will progressively reduce to 25%.

Table 6: Further company tax rate changes			
Tax year	2024/25	2025/26	2026/27
All companies	27%	26%	25%

Measures not announced or affected

Negative gearing

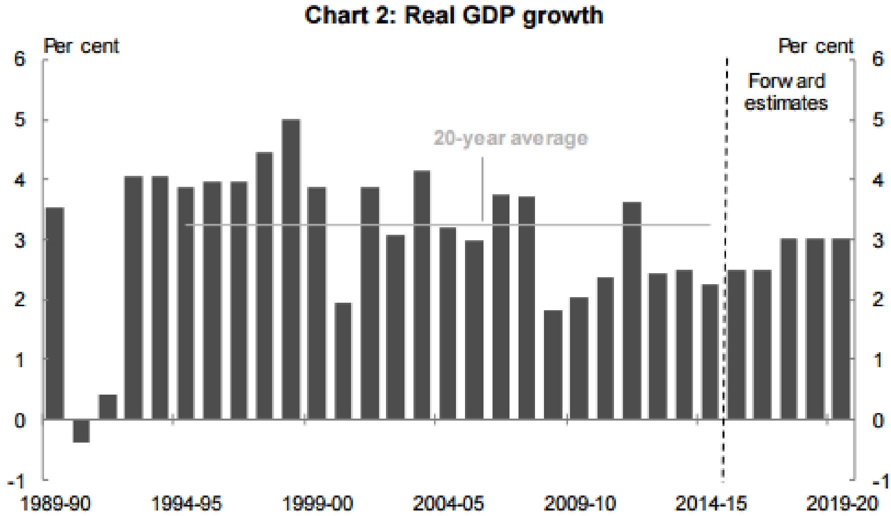
No changes will be made to negative gearing.

Age pension

No changes were announced that effect age pension eligibility or payment rates. Some important changes to the aged pension assets test have, however, were previously legislated and will take effect on 1 January 2017. These changes could impact benefits.

Economic Overview and Outlook

The assumptions and numbers underlying the Federal budget have become an increasing source of scrutiny in recent years. They provide some indication of the future prospects for our economy and the reliability or otherwise of budget projections. In this budget, the forecast is for 3% real economic growth from 2017/18 (see below) – that seems optimistic. Unemployment is projected at a modest 5.5% by June 2017, and inflation well within the Reserve Bank's target zone of 2-3% p.a. Mining investment is projected to fall a further 25.5% in 2016/17.



Source: ABS cat. no. 5206.0 and Treasury.

While China rated just a single mention in the Budget speech, it receives greater focus in the background budget papers. Caution is raised as to the extent to which our economy is tied to the economic fortunes of our largest trading partner and growing source of foreign investment capital. This is illustrated in the chart below.

Source: ABS cat. no. 5368.0, IMF April 2016 World Economic Outlook and Treasury.
Note: MTP growth aggregated using Australia's export shares.

A further key observation is that **the economy has continued to demonstrate great flexibility** to respond to changing drivers of growth, reflecting adjustments in exchange rates, wages and interest rates. Recent falls in household consumption are also seen as a positive for future consumption growth. The increasing boom in LNG production is seen as an important factor, although recent falls in energy prices and high production costs may moderate revenue and tax benefits.

A table is included in the budget papers to illustrate the **sensitivity of our growth and tax collection to fluctuations in commodity prices** (see below). Reflecting how volatile these elements can be, price expectations have been revised again since the December MYEFO. Iron ore export price assumptions have been revised up from $US39 a tonne to $US55 a tonne; metallurgical from $US73 a tonne to $US91 a tonne. This makes billions of dollars difference to forecast revenue.

Table 3: Sensitivity analysis of iron ore price movements[a]

	US$45/tonne FOB[b] spot price		US$65/tonne FOB spot price	
	2016-17[c]	2017-18	2016-17[c]	2017-18
Nominal GDP ($billion)	-6.1	-13.4	6.1	13.4
Tax Receipts ($billion)	-1.4	-3.9	1.4	3.9

(a) Key aggregates are shown relative to the 2016-17 Budget iron ore price forecast of US$55/tonne and based on an exchange rate assumption of 77 US cents.
(b) FOB is the free-on-board price which excludes freight costs.
(c) This is the price by the end of 2016-17.
Source: Treasury.

Overall, tax revenues are forecast to grow from 23.5% of GDP in 2015/16 to 25.1% of GDP by 2019/20. Expenditures do reduce, but only from 25.8% to 25.2% of GDP.

Over the four-year period to 2019/20, tax receipts are projected to grow by nearly 30%, requiring collection of an additionial $28 billion. Despite this, **the deficit** for the four years to 2019/20 is projected to be $118.5 billion - $36.5 bilion more than in last year's budget. Net debt rises from 17.3% of GDP in 2015/16 to 19.2% by 2017/18, before reducing to 9.1% in 2026/27.

Fundamentally, successive governments have done little to address the **underlying budget issues.** The medium-term problem relates to our ageing population – as clearly articulated in the Intergenerational Report back in 2002. Many categories of "age-related" spending are growing faster than GDP. The leadup to this budget illustrated yet again this fundamental problem. At a time when we need to acknowledge the reality that the Government needs to raise more revenue and/or reduce spending, discussion quickly moved to changing the tax mix, without any net tax increase. That leaves us in the current position, where future budget outcomes are very much reliant on global economic outcomes and the effectiveness of some tax integrity measures.

In summary, **the Budget papers paint a benign and broadly positive economic outlook.** Treasury relies on projected solid economic growth and some significant increases in tax revenues to move back towards a budget surplus. If these assumptions come to pass, this should provide a positive investment environment.

Disclaimer

The information contained in this Federal Budget Analysis is current as at 3 May 2016 and is prepared by Hub Wealth Management Pty Ltd AFSL 393 606.

Any advice in this Federal Budget Analysis has been prepared without taking account of your objectives, financial situation or needs. Because of this you should, before acting on any advice, consider whether it is appropriate to your objectives, financial situation and needs.

Before acquiring a financial product, you should obtain a Product Disclosure Statement (PDS) relating to that product and consider the contents of the PDS before making a decision about whether to acquire the product.