2010 Federal Budget Brief

Summary

On 11 May 2010 the Federal Government released the 2010 Budget with the major announcement that budget estimates expect a return to surplus in 2012/13, three years earlier than previously forecast.

The faster-than-expected return to surplus is premised on strong terms of trade, new tax measures for resources and tobacco, and maintaining a 2% cap on real spending growth.

There were few surprises in this budget with many of the measures in the Budget papers previously announced in the Henry Tax Review, or were corrections to inconsistency in existing legislation.

Forecasts / Projections at a glance

- The Federal Budget is projected to be in a $40.8b deficit for 2010/11, a $13b deficit for 2011/12 and to turn around to a $1b surplus in 2012/13;
- Growth (Real GDP) is projected to be 3.25% in 2010/11, 4% in 2011/12 and 3% in 2012/13;
- Unemployment is projected to be 5% in 2010/11, 4.75% in 2011/12 and 5% in 2012/13;
- Inflation is projected to be 2.5% across the three years; and
- Net debt is projected to peak at 6.1% of GDP in 2011/12 before declining to 0% of GDP by 2018/19.

From a financial planning perspective, the key budget changes include:

- Changes to superannuation concessions (Government co-contribution and new low income earners Government contribution);
- Increased superannuation guarantee (SG) rate;
- 50% discount on interest income;
- Continuation of the current transitional $50,000 concessional contributions cap for people aged 50 and over, if their superannuation balance is below $500,000;
- Increased flexibility with First Home Saver Accounts;
- Raising the superannuation guarantee age limit from 70 to 75;
- Increased flexibility with Special Disability Trusts;
- Removal of certain CGT trigger events for Instalment Warrants;
- A potentially higher deduction for investors with capital protected borrowings;
- A standard deduction for work related expenses; and
- Lower company tax rates.

Personal Tax changes

A change in the Resident Income Tax Rate

2009/10		2010/11	
0 - 6,000	0%	0 - 6,000	0%
6,001 - 35,000	15%	6,001 - 37,000	15%
35,001 - 80,000	30%	37,001 - 80,000	30%
80,001 - 180,000	38%	80,001 - 180,000	37%
180,001 +	45%	180,001 +	45%

Low Income Tax Offset	2009/10	2010/11
Max offset	1,350	1,500
Upper income threshold	63,750	67,500
Max tax free income	15,000	16,000

From 1 July 2010, the 30% tax rate will apply to those with an income more than $37,000 (up from $35,000 this financial year). Individuals with an income less than $67,500 will receive a low income offset of up to $1,500 for the 2010/11 financial year.

The amount eligible seniors can earn before they incur an income tax liability will increase to $30,685 for singles and $53,360 for couples by 2010/11.

Tax savings from new Income Tax Rates

The table below summarises the potential annual tax savings over the next year, compared to the 2009/10 financial year.

	2009/10	2010/11	
Taxable Income	Tax Payable *	Tax Payable *	Tax Saved
$20,000	$750	$600	$150
$40,000	$4,900	$4,450	$450
$60,000	$11,700	$11,250	$450
$80,000	$17,850	$17,550	$300
$100,000	$25,450	$24,950	$500
$120,000	$33,050	$32,350	$700
$140,000	$40,650	$39,750	$900
$160,000	$48,250	$47,150	$1,100
$180,000	$55,850	$54,550	$1,300
$200,000	$64,850	$63,550	$1,300

* Excluding Medicare and other offsets other than the low income offset

Medicare levy

From 1 July 2009, the Medicare levy low income threshold will be increased to $18,488 for individuals and $31,196 for families. The threshold will increase for each dependant child or student to $2,865.

The Medicare levy threshold for single pensioners below Age Pension age will increase to $27,697, with effect from 1 July 2009. This increase will ensure that pensioners below Age Pension age do not pay the Medicare levy when they do not have an income tax liability.

Discount for interest income

From 1 July 2011, individual taxpayers will be entitled to a 50% discount on up to $1,000 of interest earned on deposits (and bonds, debentures or annuity products) held with any bank, building society or credit union. The discount will be available for interest income earned directly as well as indirectly, for example from a trust or managed investment scheme.

Taxpayers claiming the discount for interest income will have their adjusted taxable income (ATI) reduced when determining eligibility for Government payments and concessions.

Comment: For a person earning an average pre-tax interest rate of 6%, the Government states that the discount would apply up to a savings balance of just over $16,500.

Standard deduction for work related expenses

From 1 July 2012, individual taxpayers will be entitled to an optional standard deduction of $500 in lieu of claiming work related expenses (and the cost of managing their affairs). The deduction will increase to $1,000 from 1 July 2013.

Taxpayers with expenses above the standard deduction will be able to continue to claim those expenses when lodging their tax return, but will need to substantiate the higher claim.

Medical expenses threshold

The threshold above which a taxpayer can claim the net medical expenses tax offset will be increased from $1,500 to $2,000 from 1 July 2010, and the threshold will be indexed annually to the Consumer Price Index, with effect from 1 July 2011.

For Aged Care residents, the daily care fees, income tested fees, bond annual retention amount, accommodation charge and periodic payments are all eligible net medical expenses.

First home saver account (FHSA) changes

The current rules require that FHSA holders keep their savings in an FHSA for four financial years before they are able to use those savings to buy a home. If a holder of such an account buys a home before the end of the four year period, the balance must be transferred to their superannuation fund.

The proposed amendment will allow savings in an FHSA to be paid into an approved mortgage after the end of a minimum qualifying period, rather than requiring it to be paid to a superannuation account.

Comment: This measure will encourage more participants to take up a program that was considered too impractical. The logic behind the original measure was to ensure the balance remained in a concessionally taxed environment.

Capital protected borrowings

Investors can currently claim a tax deduction for interest on capital protected borrowings up to the RBA indicator rate for standard variable housing loans if the loan was entered into after 13 May 2008. The residual (undeducted) amount of the interest is added to the cost base to reduce the taxable capital gain.

The deductible amount will be increased to the standard variable housing loan rate plus 100 basis points.

Comment: This measure may allow a higher tax deduction for investors. Capital protected loans entered into before 14 May 2008 will be able to claim a deduction equal to the unsecured personal loan rate until 30 June 2013.

Superannuation

Superannuation co-contribution scheme reduction

The superannuation co-contribution temporary reduction of 100% will be permanent for all workers from the 2012/13 income year. Previously the co-contribution matching rate was legislated to increase to 125% in the 2012/13 income year and return to its prior level of 150% in the 2014/15 income year.

The co-contribution decline and cut-out low income thresholds will also be frozen for the next two years at their present levels of $31,920 and $61,920.

Comment: This is a disappointing measure for low income earners who relied on this program to help boost their retirement savings. The maximum co-contribution will be capped at $1,000.

Superannuation Guarantee (SG) increased to 12%

The Government has announced that it will increase the SG rate to a maximum of 12% by the 2019/20 financial year. The change will increase in increments as outli ned in the table below.

Income year	Annual rate	Increase
2009/10 to 20012/13	9.00%	None
2013/14	9.25%	0.25%
2014/15	9.50%	0.25%
2015/16	10.00%	0.50%
2016/17	10.50%	0.50%
2017/18	11.00%	0.50%
2018/19	11.50%	0.50%
2019/20	12.00%	0.50%

Comment: The staggered increase in the superannuation guarantee will reduce the amount of salary available for salary sacrifice and/or personal deductible contributions. Salary packages that are inclusive of SG will result in a lower cash salary.

SG cut-out age extended to 75

The entitlement age for SG will be lifted for workers, with the age limit increasing from 70 to 75 years of age. This is effective from 1 July 2013.

Comment: This new SG age limit will now match the age limit for voluntary and self employed contributions. Spouse contributions will continue to be limited up to age 70.

Additional Government contribution for low income workers

The Government will make a superannuation contribution of up to 15% of the concessional contributions made by or for taxpayers on ATI of up to $37,000 (not indexed), subject to a maximum limit of $500 (not indexed). This will be effective 1 July 2012.

This means taxpayers with an ATI of $37,000 or less, in effect, will not pay contributions tax on concessional contributions.

Comment: For the self employed there is an extra incentive to make personal deductible contributions.

Concessional contribution cap for persons aged 50 or over

Workers who are aged 50 or older and have a superannuation balance of under $500,000 will be able to make concessional contributions of $50,000 per year (indexed annually).

This low superannuation balance cap applies from 1 July 2012 and effectively replaces the current transitional cap for workers aged 50 or older which expires on 30 June 2012.

Social Security

Family Tax Benefit

The Government will tighten participation requirements announced in the 2009 Budget. Under the previous Budget measure, to remain eligible for Family Tax Benefit Part A (FTB-A), families with children aged 16-20 who did not have a Year 12 or equivalent qualification would have had to participate in full-time education (or training), or part-time education (or training) leading to a Year 12 or equivalent qualification.

These participation requirements will be tightened to require families with children aged 16-20 to participate in full-time education (or training) to remain eligible for FTB-A.

Reduction in Child Care Rebate

The Government has announced that it will cap the annual Child Care Rebate to the 2008-09 level of $7,500 per child from the current annual cap of $7,778 per child. The Rebate will not be indexed and will remain at $7,500 for four years from 1 July 2010.

War Widows Pension: new de facto relationship and eligibility

The Government announced that it will remove eligibility for the War Widows (or Widowers) Pension for people whom before applying for the Pension, enter into a de facto relationship following the death of their veteran partner.

The proposed amendment (effective for claims lodged from 1 October 2010) will remove an anomaly which allows widows (or widowers) who have entered into a de facto relationship following the death of their veteran partner to claim the Pension, whereas those who have since married cannot claim it.

Special Disability Trusts

The Government will expand the definition of a beneficiary of a Special Disability Trust to include disabled individuals who are able to work up to seven hours per week.

The range of allowable uses for the trust will be increased to include all medical expenses, maintenance expenses and discretionary spending, up to $10,000 per year.

Comment: This measure is designed to extend the opportunity for families to utilise a Special Disability Trust.

Companies & Trusts

Reduced Interest Withholding Tax rate

The Government will reduce the interest withholding tax (IWT) rate paid by local subsidiaries of overseas financial institutions, from 10% to 7.5% in 2013/14 and to 5% in 2014/15. The Government has an 'aspirational goal' to reduce this to 0% over time.

Comment: This measure will allow non-major banks to access cheaper funding so they can offer cheaper loans to Australian households and businesses. The IWT reduction will not apply to interest paid on non-resident retail deposits held in Australia.

Non-commercial loan rules

The Government will further refine the non-commercial loan rules (announced in the 2009/10 Budget) by clarifying the type of payments that can give rise to a deemed dividend when they are provided to shareholders or their associates.

The measure will clarify that, where a private company provides a home to the shareholder of the private company (or their associate) for use as their main residence, a deemed dividend will not occur.

Income Tax treatment of instalment warrants

Instalment warrants allow investors to borrow in an underlying asset. In its simplest form, the investor makes an up front payment, which includes prepaid interest and borrowing fees. The underlying asset is held on trust during the life of the loan to provide limited security for the lender. Upon payments of all instalments, the trustee transfers the underlying asset to the investor.

The current interpretation of the income tax law suggests the trustee owns the underlying asset in the trust. As a result, there is a Capital Gains Tax (CGT) taxing point when the investor pays the final instalment.

The Government proposes to amend the tax law so that a superannuation trustee who enters into a limited recourse borrowing arrangement to purchase an asset will be treated as the owner of the asset for income tax purposes, with effect from 1 July 2007.

As a result there will be no CGT consequences for the trustee or investor when the investor pays the final instalment or if the trustee transfers the asset to the investor.

Reduced company tax rate from 2013/14

The Government has announced that the company tax rate will be reduced from 30% as follows:

Financial year	Rate
2013/14	29%
2014/15	28%

Small business companies: lower tax rate

The company tax rate for "eligible small business companies" will be reduced to 28% from 2012/13 (i.e. two years earlier than for other companies).

Small business write-off changes

The amount of assets that can be immediately written off by small businesses will be increased from $1,000 to $5,000. This is effective 1 July 2012.

Resource super profits tax introduced

A Resource Super Profits Tax (RSPT) will be introduced on 1 July 2012 at a rate of 40% on profits made from the exploitation of Australia's non-renewable resources.

Under the RSPT a refundable credit for royalties paid to State and Territory Governments will be available to ensure there is no 'double taxation' of resource profits. The Government will guarantee to contribute 40% of the investment cost of a resource project.

Registration of business names

The Government will establish a national system for registering business names. Currently businesses have had to register separately in each State and Territory and pay registration fees to each Government.

Under the proposed measures, businesses will need to register only once and pay only one fee. The administration of business names will be transferred from the States to ASIC.

Things for you to consider

- Review salary sacrifice arrangements and gearing strategies in light of changes to personal income tax rates;
- For those eligible, consider a non-concessional contribution of up to $1,000 to receive the maximum Government Co-contribution of $1,000 prior to 30 June 2010; and
- Review superannuation income stream payments from 1 July 2010, given that the minimum pension drawdown relief (50% of minimum pension payment) will cease from 30 June 2010.

Please note: the Budget changes outlined in this document are proposals only and will not take effect until the passing of relevant legislation.

PFS

If you have any questions regarding the 2010 Budget or require any further information, please contact your Adviser.

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