2016-17 Federal Budget

In a break from the trend of past years, the Government kept many of this year's Budget measures under wraps until Budget night. There was a lot of speculation leading up to last night's announcement, and relatively few leaks beforehand. As it turns out, there was a lot in it, including a number of welcome measures for small business - part of a package intended to help Australia transition from being a mining-led economy to something more diverse. The Budget also announced some of the most significant changes to Superannuation in the last decade. However, those interpreting the Government's recent silence on tax reform as a strategy to build anticipation for a 'rabbit-from-the-hat' reveal on Budget night will be disappointed. Overall, this Budget is far more about simple tax changes than tax reform, and in many cases the new measures are distant, and increase complexity and red-tape for those in business.

Here's just a few of the highlights.

- Small business threshold increase to $10 million
- Reduced company tax rate of 27.5% for small business
- Non-company businesses to receive increased tax offset
- 32.5% Marginal tax rate threshold to be increased
- Temporary Budget Repair Levy to be scrapped
- Superannuation accounts in pension phase to be capped at $1.6 million
- Transition to retirement pension concessions to be reduced
- Non-concessional contributions to be capped at $500,000 for the lifetime of the member
- Concessional contribution caps cut to $25,000 for all individuals
- Concessional contributions 'catch-up' to be permitted for accounts with balances under $500,000
- Superannuation surcharge threshold to reduce to $250,000
- Concessions for personal super contributions extended
- Low income super tax offset to be introduced

Small business

- **Small business threshold increase to $10 million** - If your business is defined as 'small' for tax purposes, you can access a range of additional tax concessions (for example, the much publicised 'instant asset write-off' for capital purchases under $20,000). The limit for eligibility for these concessions had been $2 million in annual turnover. From 1st July 2016, this will increase to $10 million, which will allow an estimated 90,000 to 100,000 businesses to access these concessions. Coupled with the reduced company tax rate (below), this is great for small-medium business.

It's worth noting though that the Capital Gains Tax (CGT) concessions that apply to small businesses will not be extended to those with turnover greater than $2 million but less than $10 million. This leaves us with the additional complexity now of having different definitions of 'small business' for CGT and general tax purposes, a problem that already existed in other spheres and which the Board of Taxation identified as an impediment to small business in the Government's tax review last year.

- **Reduced company tax rate of 27.5% for small business** - For companies that qualify as 'small' for tax purposes, the rate of tax will reduce for the upcoming 2016-17 financial year to 27.5%. This is down from 28.5% and with the increase in the eligibility threshold above, will affect a much larger number of businesses. This rate will reduce to 27% for the 2024-25 year, and by a further percentage point each year thereafter until it hits 25% by 2026-27. Forgive us if we're not entirely optimistic about this aspect of the proposal. 2024-25 is potentially three Governments away! The Institute of Chartered Accountants has called this approach "painfully slow" and we agree. Based on the current level of uncertainty and change, it's so far away as to be almost meaningless. There is almost no doubt that this roadmap will change sometime between now and its current end date.

  The reduced rate will be gradually rolled out to larger companies over the next decade too, such that all companies will be subject to 27.5% tax by 2023-24 and 25% tax by 2026-27.

  The incentive here is for companies to keep profits in the business and reinvest in innovation. If you're a small business owner, and you take your profits out of the business for personal use, you'll end up paying the same amount of tax anyway. You get a credit for the company tax already paid, but then you are taxed on the difference up to personal marginal rates. But if the money is reinvested in the company, the most tax that will be paid for the foreseeable future is 27.5%.

- **Non-company businesses to receive increased tax offset** - The current tax offset for small businesses that do not operate through a company (say a sole trader, partnership or trust) will increase from 5% to 8% from 1st July 2016, and will increase again to 10% in 2024-25, 13% in 2025-26 and 16% in 2026-27. Strangely though, the maximum allowable value of the offset will remain at $1,000, which means for businesses that were already receiving the maximum amount, there will be no change to the benefit.

Personal Tax

- **32.5% Marginal tax rate threshold to be increased** - In an effort to address and correct the impact of 'bracket creep', the threshold at which the 37% marginal tax rate kicks in will be increased from 1st July 2016. Currently, the rate of personal income tax changes from 32.5% to 37% on income over $80,000. This will now be increased to $87,000. The full value of the measure for someone earning over $87,000 a year is $315.

- **Temporary Budget Repair Levy to be scrapped** - The 2% Temporary Budget Repair Levy that applied to personal income over $180,000 was due to expire at the end of the 2016-17 financial year. It was announced that it would not be extended beyond its initial three years and would cease as planned.

Superannuation and retirement

- **Superannuation accounts in pension phase to be capped at $1.6 million** - Under current rules, when a superannuation fund begins paying a pension, all of the future earnings in the fund (that relate to the relevant member) become tax free. This is regardless of the total amount that is held in super, which can be very lucrative for those with large balances. From 1st July 2017, the maximum balance that can be held tax free in super during the retirement phase will be capped at $1.6 million.

  This measure is effectively an alternative method for implementing Labor's plan to tax excess earnings in super during the pension phase. Any balance over $1.6 million held in super (per member) would go back to an 'accumulation' account in the fund and earnings on that amount would be taxed at 15% as usual.

  This measure will also be applied to defined benefit schemes.

- **Transition to retirement pension concessions to be reduced** - From 1st July 2017, earnings in a fund that is paying a 'transition to retirement' pension will be taxed at 15%. These earnings had previously been tax free, which allowed an eligible individual who was still working to begin taking a pension. By so doing, they continued to receive an income from work, plus they received a tax free pension, and all of the future earnings in super became tax free. Under the new rules, the pension would continue to be tax free (assuming the member is eligible), but the earnings in the fund would continue to be taxed until the member fully retires.

  The intention here is to ensure that a transition to retirement pension is not accessed purely for tax purposes, when it is not really needed. This measure may, however, have an alternatively undesirable effect in encouraging those who would otherwise continue to work productively to consider full retirement, rather than having to pay the additional tax.

- **Non-concessional contributions to be capped at $500,000 for the lifetime of the member** - We suspected from recent Government rhetoric that the non-concessional contribution limits might come in for some moderation, however we didn't expect the change to be so immediate and brutal.

  Non-concessional contributions are amounts that members can move from outside of super (say, from their personal savings) into super. They are not the same as those that are made on employment income ('concessional' contributions). A non-concessional amount has already been taxed, and so is not taxed again when it hits the fund. It's an effective means of moving investment activity from a higher tax environment into super, where it will enjoy a lower rate of tax and help build towards retirement.

  Effective from Budget night, a lifetime cap will apply to these contributions so that the maximum amount that can be contributed in this way will be $500,000 over the life of the member. This is down from $180,000 a year or $540,000 over any three-year period. Further, the measure will apply to any non-concessional contributions made since 1st July 2007! Any amount contributed in excess of $500,000 since then (up until Budget night) will not attract any additional tax, but will render the incentive fully exhausted, such that no further non-concessional contributions can ever be made.

  While any reasonable person might agree that in difficult economic times some tweaking of this generous allowance is worth consideration (in its current form it does disproportionately benefit higher-wealth individuals), it is a measure accessed by many business owners for wider purposes than simply reducing tax, and this announcement is a significant and sudden change. For example, a business owner may use this measure to help buy a business premises in superannuation by transferring some seed capital into the fund for the deposit. This is a great way of protecting assets and providing an income stream in retirement. It's highly likely that numerous business owners are in the middle of implementing this very strategy right now, and depending on where they are at in the process, they will now have those plans thrown into chaos. This measure should have come with some kind of grandfathering provisions or at the very least should not have been made retrospective. Once again, this abrupt announcement and its implementation leads to significant uncertainty in the retirement plans of many Australians and a loss of confidence in superannuation generally - from a Government that less than 12 months ago promised that there would be no adverse changes to superannuation in the future.

- **Concessional contribution caps cut to $25,000 for all individuals** - The maximum amount that a person can put into super on a concessional basis (employer super, salary sacrifice, etc.) will be capped at $25,000 per annum for all individuals from 1st July 2017. This cap is currently $30,000 for those aged under 49 on 30th June, and $35,000 for those over. These caps had been reduced as a budget measure a few years ago but were on a path to be gradually increased over the next few years. It's changes like these that lead us to scepticism over any tax announcement that is scheduled to be implemented in future years.

  Significantly for some, particularly doctors in the public system, this cap will also be applied to defined benefit schemes.

- **Concessional contributions 'catch-up' to be permitted for accounts with balances under $500,000** - In a welcome contrast to other changes, it was announced that from 1st July 2017 individuals with a balance in super under $500,000 will be permitted to make additional concessional contributions for past years where they did not reach their limit of $25,000. For example, if a person only contributed $15,000 in the 2017-18 year, they could contribute up to $35,000 in the subsequent year. Unused cap amounts will be carried forward for five years, but only from the start date of 1st July 2017. This is a great measure for people whose work arrangements are interrupted, say where they are required to be a care-giver or have children.

- **Superannuation surcharge threshold to reduce to $250,000** - Under current rules, a person who has income over $300,000 in any given year must pay an additional contributions tax of 15% on concessional superannuation contributions. This effectively doubles the standard rate of contributions tax (15%) for high income earners. From 1st July 2017 the income threshold at which this additional tax will kick in will be lowered to $250,000.

- **Concessions for personal super contributions extended** - From 1st July 2017 all individuals up to the age of 75 will be allowed to make super contributions. Previously, those over the age of 65 were required to satisfy a 'work' test.

  Further, from 1st July 2017 any individual will now be able to claim a tax deduction for super contributions, once again up to the age of 75. Under the previous rules, this was only permitted where less than 10% of the individual's income came from employment (i.e. salary and wage income). This was an arbitrary and frustrating limitation for those who were self-employed but also had some employment income. Note that in total, the contributions cannot exceed the concessional cap of $25,000, from employer <u>and</u> personal contributions.

- **Low income super tax offset to be introduced** - The Government will introduce a Low Income Superannuation Tax Offset (LISTO) from 1st July 2017. This will apply for members with taxable income less than $37,000, and in effect ensures that they don't pay <u>more</u> tax on their super contributions than they would if they took it as employment income. It replaces, and achieves similar objectives to, the Low Income Superannuation Contributions (LISC) scheme.

Our take...

There's a lot more to this Budget than the few measures outlined here. We've attempted to cover those most relevant to our clients and provide some commentary. There is certainly some boldness to this Budget, which we salute. In particular, we applaud the increase in the small business concessions eligibility threshold, which could have the effect of providing significant additional cash flow for more Australian businesses.

There is no doubt though that this is an election Budget. Many of the measures announced last night are not due to be implemented until the start of next financial year at the earliest, which essentially requires the re-election of the Government for them to become law. One exception to this is the immediate (and retrospective) change to the non-concessional superannuation contribution limits, which seems unnecessarily aggressive.

Beyond that, we're taking a cautious, 'let's wait-and-see' approach. Some measures are scheduled so far into the future that they cannot be costed in the forward estimates. While the political and economic climate remains uncertain, and with an election just around the corner, we know from past experience with both sides of the political fence that future 'measures' are often the first to be scrapped. The Government counts on the electorate having a short memory when it comes to Budget measures, especially those not yet implemented, with the added benefit that nothing needs to go through Parliament in order to reverse a measure that was only promised rather than enacted.

Perhaps most disappointingly of all, there is no reform here, despite the repeated 'watch this space' declarations from the Government leading up to Budget night. Tax cuts for business can be a great stimulus, but do nothing to address the inherent impediments to business efficiency in this country. It seems that yet again, we have undertaken extensive and costly reviews into the tax system only to ignore the findings and resort to the much lower-risk grab-bag of minor tax measures and superannuation tweaks.

Our mailing address is:
Dewings
PO Box 170
Fullarton, South Australia 5063
Australia