



Federal Budget 2011: Spectrum Super Adviser Special Bulletin

10 May 2011

Introduction

According to the Treasurer, the Budget is getting 'back in the black' in 2012/13 (a reference which did create some disturbing mental images during the Budget speech (imagining the Treasurer playing air guitar to AC/DC). Other than some tax initiatives from the Henry Review (changes to fringe benefits tax (FBT) treatment on cars), the removal of low income tax offset for children, support for families with teenagers and welcome tax concessions for disability income trusts, there wasn't a huge amount in it for financial services. (Perhaps the Treasurer thought the financial services industry has enough on its plate with advice and super reforms and decided to (mostly) leave us alone this May.)

Listening to the Treasurer's speech, this Budget has the feel of a Budget released before the storm. The storm in this case is the carbon tax which is set to be introduced later this year. Financial planners should watch out for this as the compensation arrangements may have a significant impact on clients.

As we trawled through the Budget papers, there was a moment of excitement with the proposed introduction of refunds of excess concessional contributions, and then an almost immediate let down when we realised how limited it was. Same goes with extending the reduced minimum pension draw down to 2011/12. Our reaction was 'Great! ...Oh but it is only a 25 per cent reduction, not 50 per cent'. There is good news for employees whose super guarantee contributions are not paid and the employer company folds only to be resurrected as another entity (phoenix activity), as directors will be held personally liable for unpaid super contributions. Otherwise many initiatives affecting financial services have already been announced, such as those affecting self managed superannuation funds (SMSFs).

Following is a summary, with comments from IOOF's TechConnect team, of the announcements in Budget 2011 as it relates to financial advisers and their clients.

Taxation

Low Income Tax Offset (LITO)

As announced prior to Budget night, the Government will increase the proportion of the low income tax offset (LITO) that is delivered through workers' week-to-week pay packets from 50 per cent to 70 per cent. This change means instead of being compensated after they put in their tax return at the end of the year, lower income earners are taxed less during the year.

Someone with annual income of \$30,000 will get an extra \$300 during the year in their regular pay. A person's total LITO entitlement for any one tax year will remain unchanged.

Comment: The Government has also announced that minors receiving non-working income **WILL NOT** be entitled to the LITO from 1 July 2011.

Clients employing a transition to retirement strategy could consider salary sacrificing into super to reduce their assessable income down to \$30,000 to maximise the LITO and minimise their Medicare levy payable. Salary sacrifice contributions which are classified as employer reportable superannuation contributions are not added back when calculating the LITO and Medicare levy.

Medicare Levy low-income thresholds

With effect from 1 July 2010, the Government will increase the Medicare levy low income thresholds to \$18,839 for individuals and \$31,789 for families. They will also increase the threshold for each dependent child or student to \$2,919 from \$2,865.

The Medicare levy threshold for single pensioners below age pension age will also increase to \$30,439.

Removing minors' eligibility for the LITO

Effective from 1 July 2011 the Government will remove the ability for minors to access the LITO to reduce tax payable on income other than employment income. This means that the effective tax free threshold for minors will go back to \$416 pa.

Comment: These changes could encourage the use of investment bonds as investment vehicles for minors based on their tax paid structure at a maximum of 30 per cent.

Small business instant tax write-off

As announced prior to Budget night, from 1 July 2012 the Government will introduce the following measures for Australian small businesses:

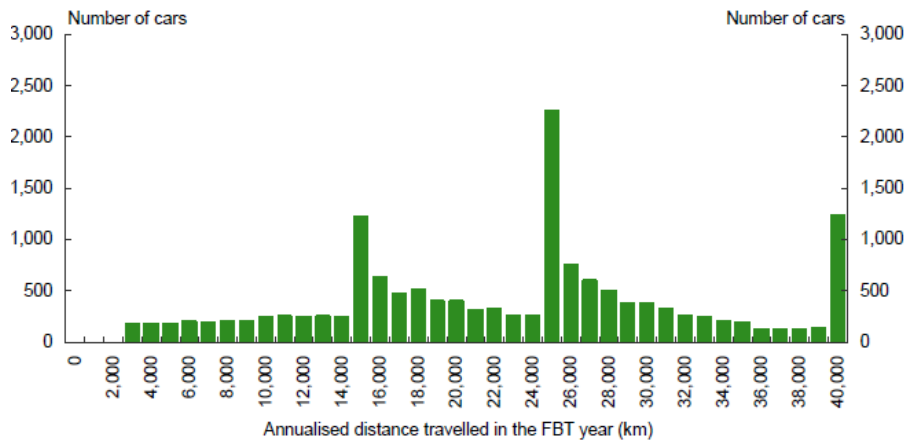
- an immediate tax write-off of the first \$5,000 of any motor vehicle purchased from 2012-13. The remainder of the motor vehicle value will be pooled in the general small business pool which will be 15 per cent in the first year and then 30 per cent. In practical terms this means a tradesman, on a 30 per cent marginal tax rate, buying a new \$33,960 ute would receive an extra tax benefit of \$1,500 in the year they purchased the vehicle
- a reduction in company tax rate to 29 per cent for incorporated small businesses.

Reforms to car fringe benefits tax – statutory formula

The Government has announced they will reform the current ‘statutory formula’ as sighted within the December 2009 Australia’s future tax system: Report to the Treasurer – December 2009 (the Henry Tax Review). The Government will replace the current formula for valuing car fringe benefits with a single statutory rate of 20 per cent, regardless of the kilometres travelled.

The following chart illustrates the current behaviour of taxpayers who salary package a car under the statutory method. The spikes in the number of taxpayers travelling 15,000, 25,000 and 40,000 km per annum coincides with the reduction in the statutory formula used to calculate the amount of fringe benefit tax payable.

Chart 1.3: Number of vehicles by kilometres travelled
2007–08 fringe benefits tax (FBT) year



Source: Australia’s future tax system: Report to the Treasurer – December 2009 – Part Two

This will only apply to new vehicle contracts entered into from Budget night 10 May 2011 and will be phased in over four years as shown below:

| Distance travelled during the FBT year (1 April – 31 March) | Statutory rate (multiplied by the cost of the car to determine a person’s car fringe benefit) | | | | |
|---|---|---|-------------------|-------------------|-------------------|
| | Existing contracts | New contracts entered into after 7:30pm (AEST) on 10 May 2011 | | | |
| | | From 10 May 2011 | From 1 April 2012 | From 1 April 2013 | From 1 April 2014 |
| 0-15,000 km | 0.26 | 0.20 | 0.20 | 0.20 | 0.20 |
| 15,000 – 25,000 km | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 |
| 25,000 – 40,000 km | 0.11 | 0.14 | 0.17 | 0.20 | 0.20 |
| More than 40,000 km | 0.07 | 0.10 | 0.13 | 0.17 | 0.20 |

Comment: Clients travelling over 25,000 km per annum or who complete work related kilometres should determine whether it would be more beneficial to use an alternative method (such as the operating cost method) when packaging a motor vehicle. For these types of clients it will mean more paperwork and tax compliance burdens, however not all employers offer salary packaging of motor vehicles outside of the default statutory method.

Dependent spouse tax offset

The Government will phase out the dependent spouse tax offset (DSTO) for taxpayers with a dependent spouse born on or after 1 July 1971.

Taxpayers with an invalid or permanently disabled spouse, supporting a carer or people eligible for the zone, overseas forces and overseas civilian tax offset will not be affected.

Disallow deductions against Government assistance payments

From 1 July 2011, the Government will amend the tax law to prevent deductions being claimed against all government assistance payments, in response to the 2010 High Court decision in *Commissioner of Taxation v Anstis*.

For financial years 2006-07 to 2009-10, the Commissioner will allow eligible taxpayers to receive an automatic deduction of \$550 or claim a higher deduction if substantiated.

Comment: This may be an opportunity to provide eligible clients and their children additional advice especially if they have expense deductions receipts greater than \$550 for these years.

Entrepreneurs' Tax Offset

The Government will abolish the Entrepreneurs' Tax Offset (ETO), with effect from the 2012-13 income year. This reform implements a change recommended by the Henry Review.

Managed Investment Trusts – clarifying 2010/11 Budget measure

The Government will defer by 12 months the start date, to 1 July 2012, and clarify aspects of the new tax system for managed investment trusts (MITs) announced on 7 May 2010.

This will provide the industry extra time to make the required trust deed amendments and systems changes.

Capital gains tax – Extensions to the main residence exemption in relation to special disability trusts

The Government will extend the capital gains tax (CGT) main residence exemption to special disability trusts (SDTs) for tax assessments for the 2006-07 and later income years. This announcement backdates the CGT main residence exemption from 1 July 2009¹ for SDTs and it also provides a CGT exemption for assets transferred into a SDT for no consideration.

In addition, the Government will provide a CGT exemption in the advent of the death of the principal beneficiary for the intended recipient of the principal beneficiary's main residence, if the recipient disposes of the dwelling within two years of the principal beneficiary's death.

Comment: The continued change to SDTs builds on the attractiveness of holding the principal beneficiary's main residence within the trust and it overcomes the CGT issues upon death for the intended recipient. This means the estate plans for the principal beneficiary's main residence can be tax efficiently incorporated within the strategy.

The announcement of the CGT exemption for assets transferred into a SDT for no consideration will reduce the barriers to provide for the future care and accommodation needs of a family member with a severe disability.

Note: The 2010 Federal Budget contained announcements for SDT's to apply from 1 January 2011 which have not been implemented. For example, one of the announcements focused on SDT's being able to spend up to \$10,000 in a financial year on discretionary items not related to the care and accommodation needs of the beneficiary of the trust.

No movement on 2010 Budget announcements

Standard deductions

From 1 July 2012, the Government will provide individual taxpayers with an optional standard tax deduction of \$500 in lieu of claiming work-related expenses increasing to \$1,000 from 1 July 2013. This means an average wage earner will receive a maximum tax return of \$300 per annum.

Interest income

From 1 July 2011, the Government will provide individuals with a 50 per cent tax discount on up to \$1,000 of interest income earned by individuals, including interest earned on deposits held in authorised deposit taking institutions, bonds, debentures and annuity products. The discount will also be available for interest income received via a trust or managed investment scheme.

¹ Tax Laws Amendment (2010 Measures No.3) Act 2010 received royal assent on 29 June 2010.

Superannuation

Refunds of excess concessional contributions

From 1 July 2011, Super funds will be able to refund to members excess concessional contributions that breach the concessional contributions cap. The refunded amount will be included in the individual's tax return. The option is only available for excess contribution up to \$10,000 and can only be utilised for first time cap breaches.

Comment: This will relate to excess concessional contributions made after 1 July 2011, and therefore apply when the ATO assesses the individual's concessional contributions against the cap after the end of 2011/12 financial year. Unfortunately this hardly touches the surface of the problems with excess contributions tax. There is no proper consideration of unfair outcomes with excess non-concessional contributions. Nor does it address the issue that a \$25,000 concessional contributions cap is simply too low.

Other contributions cap issues

The Government has reiterated it will go ahead with extending the \$50,000 concessional contributions cap after 1 July 2012 where account balances under \$500,000.

Comment: Despite strong criticism of this initiative and its inevitable implementation problems (who said Reasonable Benefits Limits were dead in the water....) the Government appears to want to go ahead with it. More complexity for super and financial planners ahead!!!!

Pension draw down relief extended into 2011/12

Rather than end the pension draw down relief that has been available to account based (allocated) pensions and term allocated pensions since 2008/09, the Government will phase it out. For 2011/12 the standard minimum draw down for account based pension will be reduced by 25 per cent, an increase on the 50 per cent reduction that applied in 2010/11 but not the full minimum pension. For 2011/12 it will reduce by 25 per cent and no reduction will apply for 2012/13.

Allocated (account based) pension minimums are set out below:

| Age | 2010/11 | 2011/12 | 2012/13 |
|---------|---------|---------|---------|
| to 64 | 2.00% | 3.00% | 4.00% |
| 65 - 74 | 2.50% | 3.75% | 5.00% |
| 75 - 79 | 3.00% | 4.50% | 6.00% |
| 80 - 84 | 3.50% | 5.25% | 7.00% |
| 85 - 89 | 4.50% | 6.75% | 9.00% |
| 90 - 94 | 5.50% | 8.25% | 11.00% |
| 95+ | 7.00% | 10.50% | 14.00% |

Comment: Current pension clients who have elected to take the minimum pension under their account based (allocated) pensions will receive the new rate commencing 1 July 2011. This requires only a regulation change and does not need to pass through Parliament to be implemented. Although technically Parliament can disallow regulations, this would seem extremely unlikely in this case.

Superannuation co-contribution

The freezing of the co-contribution indexation will be extended for a further year to 2012-13. The matching contribution is up to \$1,000 for people with incomes of up to \$31,920 in 2010-11 (with the amount available phasing down for incomes up to \$61,920). This measure will continue to freeze the thresholds at \$31,920 and \$61,920 respectively.

Superannuation guarantee contributions

From 1 July 2011, company directors will be personally liable for their company's failure to pay employee superannuation. This measure is in response to fraudulent phoenix activity where a company intentionally acquires debt to improve cash flow or wealth and then liquidate the company to avoid paying the debt. The company is subsequently continued as another corporate entity, controlled by the same person, free of previous debts.

Comment: This measure will provide protection for workers against unscrupulous employers who seek to avoid their superannuation liabilities.

Temporary loss relief for superannuation funds mergers

The Government has extended the end date of the temporary loss relief for complying superannuation funds mergers by three months to 30 September 2011.

Comment: This will provide additional time for superannuation funds to merge in a compliant order.

No movement on 2010 Budget announcements

Low income earners Government contribution

From 1 July 2012, the Government will provide a contribution of up to \$500 annually into the superannuation account of workers on adjusted taxable incomes of up to \$37,000. This will provide a reward for savings for low income earners by ensuring no tax is paid on SG contributions.

Self managed superannuation funds

Stronger Super

The annual SMSF levy will increase from \$150 to \$180 per annum, as previously announced.

An additional \$40.2 million will be allocated to the ATO and \$8.4 million to ASIC to implement a range of measures relating to the SMSF sector including:

- the introduction of administrative penalties that the ATO can apply in cases of non-compliance by SMSF trustees
- the introduction of knowledge and competency requirements on SMSF service providers
- the registration of SMSF auditors (which will include a registration fee)
- tightened legislative restrictions on SMSF investment in collectables and personal use assets
- requiring SMSFs to value their assets at net market value and the ATO to publish valuation guidelines
- the appointment of the ATO to collect and publish data on the sector
- changes to the registration and rollover processes, and illegal early release penalties to deter the use of SMSFs for illegal activity.

Comment: The additional \$30 per fund will raise approximately an additional \$13.5 million per annum or \$68 million over five years, which should cover the additional amounts allocated.

Capital gains tax — limiting the trading stock exception for superannuation funds

The Government will remove the CGT trading stock exception rule for complying superannuation entities for specified assets (primarily shares, units in a unit trust and property). This measure will prevent the small number of superannuation funds who seek to treat these assets as trading stock and therefore deduct losses against income rather than capital gains.

Comment: This measure will have a negligible impact on most funds and is consistent with the sole purpose test.

Amendment to the definition of an SMSF

The definition of an SMSF will be amended to enable a fund with a corporate trustee to allow a parent or guardian to be director of the body corporate in place of a member that is a minor.

Comment: This amendment corrects an existing unintentional anomaly in the SIS legislation.

Social security (including child support)

Disability Support Pension

Allow all recipients to work up to 30 hours a week

The Government will allow all Disability Support Pension (DSP) recipients to work up to 30 hours a week and remain eligible for a part-pension for up to two years. This will allow recipients granted DSP under the 15 hour a week rule (on or after 11 May 2005) to maximise their working hours without the suspension of their DSP entitlement. DSP recipients will still be subject to the application of the income test.

Participation requirements

The Government will introduce participation requirements for new and existing DSP recipients under the age of 35 with some work capacity from 1 July 2012. Existing recipients under the age of 35 without an assessed work capacity level, whom Centrelink deem likely to benefit from participation interviews, will undergo a revised assessment to determine whether they have a partial work capacity of eight or more hours per week.

More efficient and accurate assessments for Disability Support Pension

The Government will bring forward the implementation of more efficient and accurate assessments for Disability Support Pension and employment services from 1 January 2012 to 2 September 2011.

From 3 September 2011, DSP claimants will need to provide evidence that they have tested their future work capacity by participating in training or work related activities. This activity test will not apply to claimants who are clearly unable to work, for example if they are unable to work due to profound disability.

Portability changes

The Government will provide indefinite portability of the DSP from 1 July 2012, where a recipient has a severe and permanent disability and no future capacity to work. Indefinite portability will allow eligible DSP recipients to continue to receive payments while living overseas. DSP recipients who decide to stay overseas for longer than 13 weeks will no longer be entitled to add-on payments such as the Pension Supplement or Rent Assistance.

Comment: These announcements are consistent with the Government's intentions of increasing the employment participation rate within Australia as announced in the lead up to the Budget. Advisers need to discuss with their client whether or not it is worthwhile to increase their number of hours worked due to the reduction in their DSP under the income test.

Family Tax Benefit Part A

More assistance for families with teenagers

As announced prior to Budget night, one of the aims is to improve the adequacy of Family Tax Benefit (FTB) Part A for dependent 16 to 19 year olds in full time secondary study. This will simplify the assistance provided to families with children in this age group, removing the need to choose between Youth Allowance and FTB.

FTB and Youth Allowance will be changed to:

- match the payment rates of FTB Part A for dependent 16 to 19 year olds in full time secondary study to the rates for 13 to 15 year olds. This will increase the level of support provided by FTB by up to \$4,208 a year for 16 and 17 year olds and up to \$3,741 a year for 18 and 19 year olds
- align the participation requirement for FTB Part B and the Multiple Birth Allowance with the existing FTB Part A participation requirement. This change will require 16 to 19 year olds to be undertaking full time secondary study, or be exempt from this requirement, to be eligible for these payments
- include all 16 to 19 year olds in full time secondary study for the purposes of calculating the Youth Allowance parental income test. This will ensure Youth Allowance recipients do not experience a lower rate of assistance as a result of siblings aged 16 to 19 years old in full time secondary study remaining in the FTB system.

Youth Allowance will continue to be available for 16 to 19 year olds who are independent, away from home or not in full time secondary study. All Youth Allowance recipients aged 16 to 19 on 1 January 2012 will have the option to remain on Youth Allowance.

Comment: This will be a welcomed announcement for families with teenagers at school to help fund the cost of living. Advisers should not forget to remind their clients about the maximum education tax refund of \$794 (2010/11 financial year) for each secondary school child which is aligned to the payment of Family Tax Benefit Part A

Aligning FTB Part A eligibility with Youth Allowance age of independence

From 1 January 2012, the Government is also lowering the maximum age of eligibility for FTB Part A from 24 to 21, recognising that young people aged 22 and over are considered independent. This will bring FTB Part A in line with the reduction in the Youth Allowance age of independence to 22 from 1 January 2012.

Young people aged 22 and over in full-time study may be able to access Youth Allowance independent of their parents' income, subject to means testing and academic progress rules.

More flexible advances

The Government will provide families who receive the Family Tax Benefit Part A with more flexible access to advance payment of their entitlements, allowing them to better meet unexpected expenses.

From 1 July 2011, families will be eligible for an advance of up to 7.5 per cent, up to a maximum of \$1,000, of their annual Family Tax Benefit Part A entitlement. Advances will be repaid over six months by reducing future fortnightly Family Tax Benefit payments.

Families will also be able to apply to receive an advance of the minimum amount of around \$160 on a regular basis, paid every six months. Families who choose to receive a continuous advance will also be able to take one-off advances to cope with unexpected expenditure requirements.

Comment: This will provide assistance for many families to manage the cost of living and managing cash flows to better meet unexpected expenses. Advances can be taken at any point throughout the year although the Government has stipulated that the payment of the advances will be subject to an assessment of a family's ability to repay the advance without falling into financial hardship.

Indexation of higher income limits

The Government is building on reforms introduced in the 2009-10 Budget that better targeted the family payment system to focus on low and middle income families. To do this, the Government will extend indexation pauses on higher income limits for a further two years until 30 June 2014 in the following areas:

- the FTB Part B primary earner income limit will remain at \$150,000
- the income limit for receiving dependency tax offsets will remain at \$150,000
- the Baby Bonus eligibility limit will remain at \$75,000 family income in the six months following the birth or adoption of a child (equivalent to \$150,000 a year)
- the Paid Parental Leave income limit will stay at \$150,000 for the primary carer in the previous financial year before the birth of the child
- the higher income free area of FTB Part A will remain constant. For example, this means the income cut-out for a family with two children under 18 will be limited to around \$113,000 in 2014. Each family's income limit depends on the number and age of their children.

Comment: Clients need to be aware of the continued freeze in these thresholds and the potential impact to their household income should they fail to remain within them. Clients should be familiar of the income definition for each payment and actively plan to remain within the upper income limits (such as maximise deductions to reduce taxable income for FTB Part B primary earner income limit of \$150,000).

Paid paternity leave for fathers

The Paid Parental Leave scheme began on 1 January 2011, and is already helping working parents as they take time off to care for their newborns. When introduced, Australia's Paid Paternity Leave will be extended to include fathers with two weeks' paid paternity leave who would otherwise be taking unpaid leave.

The scheme will begin on 1 January 2013, instead of 1 July 2012. The Government is seeking more time for consultation with businesses and families, and ensure legislation can be drafted and introduced into the Parliament next year.

Comment: The Government first made this announcement in September 2010 and a delay in its implementation will be a disappointment to those families planning towards commencing a family. Further details will be forthcoming via the consultation process, however whether this announcement will ever become a reality remains to be seen.

For more information, speak to your relationship manager or call our adviser service team on **1800 333 909**.

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