FirstTech Budget briefing

May 2013

Contents

Introduction

Federal Treasurer Wayne Swan has handed down his sixth Budget, which confirms a range of recently announced proposed changes to superannuation, income tax and the Medicare Levy. It also announces a range of proposed changes to the social security and tax systems.

This FirstTech briefing discusses the impact to clients and recommended client strategies of the proposed changes announced in the Budget, particularly focusing on the following six key announcements:

- confirming proposed changes to superannuation announced on 5 April 2013
- increasing the Medicare Levy by 0.5% from 1 July 2014
- not proceeding with tax cuts that were legislated to apply from 1 July 2015
- phasing out the Net Medical Expenses Tax Offset
- limiting tax deductions for self-education expenses
- trialing means test concessions for pensioners looking to downsize their homes.

It is important to note that all announcements mentioned are proposed only at this stage, and may change prior to being legislated.

Top six Budget proposals

Superannuation reforms reconfirmed

The Government has reconfirmed its intention to implement the following superannuation reforms:

- taxing earnings in pension phase that exceed $100,000 pa
- recognising deferred annuities for earnings tax concession purposes
- increasing the concessional contributions cap to $35,000 from:
  - 1 July 2013 for those aged 60 and over
  - 1 July 2014 for those age 50 and over
- increasing the ability to refund excess concessional contributions and allowing excess concessional contributions to be taxed at a client's marginal tax rate
- deeming account based pensions under the social security income test
- increasing the balance threshold below which certain lost super must be transferred to the ATO
- establishing a Council of Superannuation Custodians

FirstTech comment

As the Government had already announced its planned superannuation reforms on 5 April 2013, the Budget contained no further surprises for superannuation.

For further detailed information on the superannuation reforms, refer to FirstTech Update: Government superannuation reforms announced.

The Government has clarified that for the purposes of the proposed taxation of earnings in pension phase above $100,000 pa, capital gains that are subject to tax will receive a 33 per cent discount and will therefore be taxed at 10 per cent.

Increase in the Medicare Levy from 1 July 2014

The Government has confirmed that it will increase the Medicare Levy by half a percentage point from 1.5% to 2% from 1 July 2014 to provide funding for DisabilityCare Australia.

Draft legislation to give effect to this change has already been released.

Low income earners will continue to receive relief from the Medicare Levy through the low income thresholds for singles, families, seniors and pensioners.

The current exemption from the Medicare Levy will also remain in place, including for blind pensioners and sickness allowance recipients.

FirstTech comment

While this announcement will increase the amount of Medicare Levy people will pay on their taxable income, it will also increase the tax rates applicable to other amounts that include the Medicare Levy rate. These include:

- Excess non-concessional contributions tax – 46.5% to 47%
- Tax on the taxable component of a superannuation lump sum benefit received by a taxpayer age 55 to 59 in excess of the low rate cap (currently $175,000) – 16.5% to 17%
- Tax on the taxable component of a superannuation lump sum benefit received by a taxpayer under the age of 55 – 21.5% to 22%
- Tax on the taxable component of a superannuation lump sum death benefit paid directly to a non-death benefits dependent
    - taxed element - 16.5% to 17%
    - untaxed element - 31.5% to 32%
- Withholding tax on financial investments where no TFN is provided - 46.5% to 47%
- Fringe benefits tax – 46.5% to 47%

The increase in the Medicare Levy may also improve the tax effectiveness of a number of strategies. These include:

- making salary sacrifice and personal deductible contributions more tax effective, as the Medicare Levy does not apply to these amounts
- delaying the withdrawal of any taxable component as a superannuation lump sum benefit until after age 60, as the Medicare Levy does not apply to these amounts
- arranging for a member's death benefit to be paid to a non-death benefits dependent via the member's estate, as the Medicare Levy does not apply to deceased estates

Reforms to deductions for work-related self-education expenses from 1 July 2014

The Government confirmed in the budget the treasury's announcement on 13 April 2013 that a $2,000 cap on tax deduction claims for work-related self-education expenses per individual will be introduced.

Education expenses include formal qualifications and associated tuition fees, textbooks, stationery and travel expenses and also conferences, seminars and self-organised study tours.

There will be no change to employers receiving exemptions on fringe benefits tax for eligible education and training that they provide or fund for their employees, unless an employee decides to salary sacrifice in order to obtain these benefits.

FirstTech comment

Self-education expenses such as attending conferences, travelling and accommodation can be quite expensive and easily lead to breach of the $2,000 cap. Clients may also have to spread out self-education expenses over different financial years to stay within the annual limit and take full advantage of deductions, i.e. paying for the course in June and purchase textbooks in July the following year.

Net medical expenses tax offset (NMETO) phase out from 1 July 2013

The Government will phase out the net medical expenses tax offset (NMETO), with transitional arrangements for those currently claiming the offset. However, the offset will continue to be available for taxpayers for out-of-pocket medical expenses relating to disability aids, attendant care or aged care until 1 July 2019.

From 1 July 2013 those taxpayers who claimed the NMETO for the 2012‑13 income year will continue to be eligible for the NMETO for the 2013‑14 income year if they have eligible out of pocket medical expenses above the relevant thresholds. Similarly, those who claim the NMETO in 2013‑14 will continue to be eligible for the NMETO in 2014‑15.

FirstTech comment

Clients who are considering elective medical procedures that qualify as eligible out-of-pocket medical expenses i.e. major dental procedures may wish to bring forward the procedure and incur the expense in the 2012-13 financial year. This way they may be able to remain eligible for the NMETA for future years under the transitional arrangements.

Supporting senior Australians – housing help for seniors pilot from 1 July 2014

The Government will introduce a trial means test exemption program for Age Pension recipients who are downsizing from their family home. Under this program the family home must have been owned for at least 25 years with at least 80 per cent of any excess sale proceeds (up to $200,000) from the family home deposited into a special account by an authorised deposit taking institution. The funds in this account (including interest earned) will be exempt from pension means testing for up to 10 years as long as there are no withdrawals from this account.

People who are assessed as home owners who moved into a retirement village or granny flat will also have access to this exemption, however, it is not proposed to be available to those moving into residential aged care.

The trial will be closed to new customers from 1 July 2017.

FirstTech comment

At this stage it is not clear how funds in the 'special account' will impact an eligible person's partner who is receiving a social security entitlement other than a pension, such as Newstart Allowance. There has also been not clarification if this trial program will extend to Department of Veterans' Affairs recipients.

Deferral of 1 July 2015 tax cuts

The Government has announced it will defer the tax cuts that were due to come into effect from 1 July 2015. As a result, the marginal tax rates are proposed to remain at their current settings.

Marginal tax rates that were legislated to apply from 1 July 2015 (now proposed to be deferred)		**Current marginal tax rates**	
Taxable income	**Tax rate**		**Tax rate**
0 - **$19,400**	0%	0 - **$18,200**	0%
$19,401 - $37,000	19%	**$18,201** - $37,000	19%
$37,001 - $80,000	**33%**	$37,001 - $80,000	**32.5%**
$80,001 - $180,000	37%	$80,001 - $180,000	37%
$180,001 and over	45%	$180,001 and over	45%

As a result of these changes taxpayers earning up to $35,000 will have the maximum tax cut of $228 deferred until some future date yet to be announced. Taxpayers earning $80,000 or over will be unaffected by this change.

Other super and tax changes

Further clarification on proposed additional 15% tax on concessional contribution for high income earners

The Government has announced that it will make minor amendments to the proposed reduction of tax concessions for the concessional contributions of very high income earners, effective from 1 July 2012.

These minor amendments involve:

- exempting the employer contributions of certain Federal judges as well as employer contributions made to constitutionally protected funds for certain State employees (to mitigate constitutional risks);
- using a similar definition of income to that used when calculating whether an individual is liable to pay the Medicare levy surcharge; and
- refunding former temporary residents the tax paid under the measure as they effectively do not receive any concessional tax treatment on their contributions to superannuation as a result of the operation of other rules.

Technical amendments to low income superannuation contribution (LISC)

Currently the Government will not pay LISC if the entitlement is less than $20. Under this technical amendment, the Government will pay entitlements below $20. For an entitlement under $10 it will be rounded up to $10.

Foreign resident CGT – 10% withholding tax from 1 July 2016

The government announced a 10% non-final withholding tax that will apply to the disposal of certain taxable Australian property by foreign residents. This measure will not apply to residential property transactions under $2.5 million or to disposals by Australian residents.

Tax agent services licensing regime

The Government will provide a single online registration for financial advisers registered with ASIC that also need to be registered with the ATO as tax advisers from 30 June 2013. The ATO will charge financial advisers for registration from 1 July 2015, with proposed fees ranging between $200 and $400.

Removing the discounts applying to up-front and voluntary payments made under the Higher Education Loan Program (HELP) from 1 January 2014

It is proposed that the following will be removed:

- The 10 per cent discount to students electing to pay their student contribution up-front; and
- The 5 per cent bonus on voluntary payments to the Australian Taxation Office of $500 or more.

Preventing ‘dividend washing’ from 1 July 2013

The Government proposes to close a taxation loophole that enables certain sophisticated investors to engage in ‘dividend washing’ and effectively trade franking credits.

‘Dividend washing’ refers to the practice where an investor sells shares with a dividend and then immediately buys equivalent shares that still carry a right to a dividend. This enables the investor to effectively receive two sets of franking credits for the same parcel of shares, which is not the intent of the dividend imputation system.

The measure announced by the Government will be targeted to the two-day period after a share goes ex-dividend and will result in the investor only being entitled to use one set of franking credits.

The Government intends consulting on the development of the legislation.

FirstTech comment

What is not clear from this announcement is the interaction of the proposed ‘dividend washing’ restrictions with the existing 45-day franking credit trading rules, including any application of the small shareholder exemption.

Other social security and family assistance changes

Pension Bonus Scheme — ceasing late registrations from 1 March 2014

On 20 September 2009, the Government closed the Pension Bonus Scheme (PBS) to new entrants and replaced it with the new Work Bonus. Currently, late registrations for the PBS may be accepted for those who can demonstrate they were able to meet the PBS eligibility criteria as at 19 September 2009.

FirstTech comment

Eligible clients still have an opportunity to register before 1 March 2014 and receive the tax free lump sum bonus when they stop working and claim the age pension.

Increasing and indexing the income free area for eligible income support recipients from 20 March 2014

The Government will increase the income free area for eligible income support recipients from $62 per fortnight to $100 per fortnight from 20 March 2014 and commence annual indexation of the income free area from 1 July 2015 in line with the consumer price index (CPI). The payments affected by this change are Newstart Allowance, Sickness Allowance, Parenting Payment Partnered, Widow Allowance and Partner Allowance.

FirstTech comment

The net effect of this measure is that clients who are on these affected allowance payments, eg Newstart Allowance, will receive an increase in payment rate of up to $19 per fortnight. Also, the annual indexation of the income free area will ensure the benefits of this increase are not eroded over time.

Various changes to Government family payments

The Government has announced a number of changes to the eligibility and payment rules for Family Tax Benefit (FTB) Part A as well as other family payments. These are summarised as follows:

- From 1 January 2014, eligibility for FTB Part A for children aged 16 years and over will change so that FTB part A will only be paid until the end of the calendar year a child completes school
- The indexation of the upper income test limit of $150,000 for FTB Part B, the dependency tax offsets, the Paid Parental Leave Scheme and Dad and Partner Pay will be paused until 1 July 2017. The upper income free area for FTB Part A and FTB supplements will also remain at current levels until 1 July 2017.
- From 1 March 2014, the Baby Bonus will be abolished. It will be replaced with an additional payment for families eligible for FTB Part A. The

additional payment is $2,000 in the year following the birth or adoption of a first child or each child in multiple births, and $1,000 for the second or subsequent children.

- The allowed period of temporary absence from Australian while remaining eligible for FTB Part A will reduce from three years to one year from 1 July 2014. This change also applies to the Schoolkids Bonus and Paid Parental Leave.
- The Government will not go ahead with the planned increase to Family Tax Benefit Part A as announced in last year's Federal Budget. The pledged increases were to take effect from 1 July 2013, where the maximum rate of Family Tax Benefit Part A was going to be increased by $300 per year for families with one child, and $600 per year for families with two or more children.

The Farm Household Allowance (FHA)

The Government has announced a new Farm Household Allowance (FHA) under National Drought Program Reform, commencing from 1 July 2014. It will replace the existing Exceptional Circumstances Relief Payment and Transitional Farm Family Payment.

FHA will be available to eligible farm families in periods of hardship regardless of the source of that hardship. Eligibility will be determined through an assessment of the farmer's existing assets, liabilities and income.

The FHA will be paid at the Newstart Allowance rate, with farmers able to come on and off the payment until the maximum period of three years is reached.

A condition of receiving FHA will be completion of individually tailored reciprocal obligations (for example, certain training or development activities).

Commonwealth Disaster Recovery Allowance

The Government has confirmed that the previously announced Disaster Recovery Allowance will commence on 1 October 2013 and will, for future declared disasters, be provided to eligible people who have had their pre-disaster income temporarily affected as a direct result of the disaster. The allowance will be income tested and will replace the existing Disaster Income Recovery Subsidy payment.

This proposed measure was introduced into the House of Representatives on 20 March 2013 in *Social Security Legislation Amendment (Disaster Recovery Allowance) Bill 2013*.

Child Care Benefit and Rebate measures from 1 July 2012

The Government will continue to pause the indexation of the annual cap on the Child Care Rebate for a further three years. The maximum amount of rebate that can be paid will remain at $7,500 a year until 30 June 2017. The percentage of out-of-pocket expenses that will be reimbursed remains at 50%.

In addition, from the 2012-13 year, families will have twelve months rather than the current two years from the end of the relevant financial year for which the family is claiming the Child Care Rebate and Benefit to reconcile their income, initiate lump sum claims and satisfy any requirements for end of year supplements. Most families will have the information they need for income reconciliations within this timeframe from their tax returns. Extensions to this time limit will be provided in exceptional circumstances, similar to arrangements for tax return lodgements.

FirstTech comment

The pause in indexation of the Child Care Rebate was originally announced in the 2010 Federal Budget with effect for four years. This announcement means that the maximum rebate amount will be frozen at 2008-09 levels for seven years.

Aged care reforms – accommodation bond insurance

The Government has confirmed that it is deferring the requirement for aged care providers to take out insurance on accommodation bonds paid by aged care residents due to industry concerns.

This measure was previously announced as part of the Government's *Living Longer Living Better* reforms to the aged care system.

The Government will continue to guarantee accommodation bonds in the event that an aged care provider becomes bankrupt or insolvent.