2016 FEDERAL BUDGET COMMENT

Politics vs. Good Policy – There are no Winners!

It may well be impossible to implement budgetary policy in the national interest in the current political environment.

The **2016 Federal Budget** was doomed from the outset because it is not part of a well thought out and cohesive long term plan. One path to creating and sharing a vision was the now abandoned tax White Paper process. Much needed voter awareness and understanding is left to a free for all of opportunistic press, slogans and biased short-sighted coverage by some media, the ABC in particular.

Some of the tax policies in the Budget are sound. Reducing the corporate tax rate in line with international competiveness is a good move, particularly if businesses looking to locate here can have certainty. Any certainty now has been destroyed by party politics.

Abandoning an increase in the Goods & Services Tax is a horrible mistake. Having a tax system with up to a 20.5% (and rising) differential between the corporate tax rate and the top personal income tax rate (currently 49%) is already unworkable. There is simply too much reliance on personal income tax as a tax base, especially given the ever expanding welfare and government services budget. Most of the complexity and inefficiency in the income tax system derives from overreliance on taxes on income and the tax rate differential, yet the voting public have no clue.

The way superannuation has been dealt with as a last minute emergency budget measure is an absolute disgrace. If there is a problem with over generous superannuation settings for baby boomers, it has existed since 2007. These sudden retrospective changes, put in place to balance the current budget and try and outmaneuver the opposition party, completely undermine the ability of later generations to provide for their retirement. Shorten is already cashing in on the retrospectivity aspect so the plan is a loser on all counts.

Current tax and interest rate settings are conducive to continuing asset price bubbles.

Remember there is a lot to transpire before any of this Budget comes to fruition. Following is a basic summary with some things to think about. I have a more detailed working version that can be emailed to you on request. Please contact us if you have any specific concerns. Buckle up for some nauseating politics!

Regards, Nick Chancellor

SUMMARISED KEY POINTS: FOR OUR CLIENTS

PERSONAL TAX RATES AS ANNOUNCED

Personal income tax rates and thresholds				
	2015-16		*2016-17*	
	Threshold	*Rate*	*Threshold*	*Rate*
1st rate	$0 - $18,200	0%	$0 - $18,200	0%
2nd rate	$18,201 - $37,000	19.0%	$18,201 - $37,000	19.0%
3rd rate	$37,001 - $80,000	32.5%	$37,001 - $87,000	32.5%
4th rate	$80,001 - $180,000	37.0%	$87,001 - $180,000	37.0%
5th rate**	$180,001	47.0%	$180,001	47.0%

With Medicare levy included, the top marginal rate is 49% from 1 July 2014 to 30 June 2017.

Includes **2% Temporary Budget Repair Levy. As confirmed in the Budget this will cease at the end of the 2016/17 financial year.

Comment:

- *Bracket Creep change highlighted*
- *Backpacker Tax – Working holiday visitors will have to pay non-resident tax rates from 1 July 2016 as previously announced (not yet legislated).*

SMALL BUSINESS THRESHOLD INCREASE FROM $2M TO $10M

- Allows access to the new small business company tax rate of 27.5% **from 1 July 2016**.
- Allows access to small business concessions including $20k asset write off until June 2017 (then less than $1k) and 12 month prepayments deductibility.
- Allows the option to elect into Cash Basis for GST, and payment of GST by instalments.
- Thresholds for the very generous but complex Small Business CGT Concessions remain at $2m Turnover / $6m Net Asset Value

Comment:

- *Dividends are frankable at 30% regardless of the tax rate paid until credits run out. Most companies now carry credits surplus to profit reserves, but that may change and will need to be monitored.*
- *Small business company tax rate reductions lose their impact when profits are drawn triggering tax at rates relevant to shareholders. Rate changes benefit companies re-investing profits.*

REDUCTION OF COMPANY TAX RATE TO 25% OVER TEN YEARS

Income year	Threshold (< $)	Rate (%)
2015-16 (current year)	2m	28.5
2016-17	10m	27.5
2017-18	25m	27.5
2018-19	50m	27.5
2019-20	100m	27.5
2020-21	250m	27.5
2021-22	500m	27.5
2022-23	1bn	27.5
2023-24	all companies	27.5
2024-25	all companies	27.0
2025-26	all companies	26.0
2026-27	all companies	25.0

Comment:

- *Rates will presumably apply whether or not the company operates a business.*
- *Companies will be more attractive as investment vehicles provided imputation is not tinkered with. Complexity associated with trusts is becoming a disincentive to use them. Promised trust tax reform is off the agenda at the moment.*
- *Until otherwise legislated, dividends are frankable at 30% regardless of the tax rate paid until credits run out.*
- *A reduction in the company tax rate to almost half of the top personal tax rate will push the tax system to greater inefficiency due to the necessity to cover all arbitrage opportunities because of the rate difference. The budget flagged further changes to Division 7a which is one of the main provisions regulating the tax rate differential.*

SUPERANNUATION SHOCKER!

- Tax exempt pension accounts restricted to $1.6m per member **from 1 July 2017**, with RETROSPECTIVE application to pre-existing pension accounts. Excess amounts must either be withdrawn or transferred to “accumulation status” where 15% earnings tax and Capital Gains (10% on Discounted Gains) applies.
- Tax exemption removed in relation to Transition to Retirement pension accounts (TRIS) from 1 July 2017 with RETROSPECTIVE application to TRIS pensions commenced prior to that date. Under the changes, earnings from assets supporting TRISs will be taxed at 15% (instead of the current 0%).
- New – Non-concessional contributions lifetime cap $500k with immediate effect and RETROSPECTIVE application to contributions since 1 July 2007. Resultant reduction of effective lifetime contribution cap of $13.5m (over 75 years) – a 96% Reduction.
- Annual Concessional Contribution Cap reduced to $25k for everyone from 1 July 2017.

- Division 293 threshold for triggering extra 15% tax on contributions lowered from $300k Adjusted Income to $250k from 1 July 2017.
- Anti-Detriment deduction strategies will be outlawed from 1 July 2017.

Associated measures providing more flexibility may offset a little of the nastiness:

- Rolling five year carry forward for unused concessional contribution cap amounts starting **from 1 July 2017** for members with balances below $500k.
- Restrictions on deductibility of personal (non employer) super contributions such as the 10% rule the work test and the work income rule for persons under 18, will be removed from 1 July 2017.
- Removal of the work test for contributors aged 65-74 from 1 July 2017.
- Up to $500 Low Income Superannuation Tax Offset (LISTO) to be introduced for individuals with adjusted income below $37k commencing 1 July 2017.
- Access to Low Income Spouse Super Tax Offset (up to $540 p.a. for the contributing spouse) extended by increasing the income threshold of the low income spouse from $10,800 to $37,000 from 1 July 2017.

Comment:

- *The July 2017 start date for most changes reflect the impact of the looming election and the mess that an earlier start date could create.*
- *Everybody will need to review their retirement and superannuation strategy as a result of these changes.*
- *Of immediate concern is the prospect of breaching the new $500k cap which is already in force by announcement. Contributions made before commencement cannot result in an excess of the Lifetime cap. Excess contributions made after 3 May 2016 will need to be removed or subject to penalty tax. That is assuming the Coalition is elected and the law gets through.*
- *Using available concessional caps each year takes on far more importance in terms providing adequately for retirement.*
- *Bringing non-concessional contributions forward in life to allow them to grow will be a consideration but an impossibility for most.*
- *Triggering Capital Gains tax free within currently tax free pension accounts before compulsory conversion on 1 July 2017 of excess levels will be a big consideration. Whatever happens it might be wise to start looking at that now being careful not to sell and re-purchase in a way that is obviously a "wash sale".*
- *Equalization of super balances between spouses where possible will be a priority to maximize the overall benefit of the new caps.*
- *SMSFs may decline in popularity if this all gets through.*
- *Proposals to restrict non-concessional contributions apparently do not extend to additional amounts up to $1.395m per person associated with the Small Business CGT concessions.*
- *Administration and advice costs will rise due to the need to track contributions history and unused caps among other things.*

WHAT'S NOT IN THE BUDGET:

Looking at what is not in the Budget is probably equally important:

- ✘ *A coherent tax reform plan* – Tax White Paper process abandoned.
- ✘ *Significant spending cuts* including welfare to millionaire homeowners.
- ✘ *Changes to negative gearing* – a red herring given the level of interest rates.
- ✘ *Changes to the CGT 50% discount and generous but complex CGT Small Business Concessions.*
- ✘ *Outlawing or restricting SMSF gearing* - this is a time bomb waiting to go off. Restricting contributions will squeeze those heavily underwater.
- ✘ *Tax reform of trusts* – a mainstay of families and small business needs fixing.
- ✘ *Death duties* – the way things are headed stay on the lookout. It was flagged in the Rudd / Swan Henry review.
- ✘ *Expansion of Land Tax* – A state by state issue but squeezing of federal funding may force the hands of the states.
- ✘ *Certainty about anything really!*

MORE INFORMATION?

Considering the ramifications of this particular Budget for our clients has been very time consuming with the prospect that some or all of the measures announced will never be legislated. Rephrasing the Budget detail is a waste of time.

Should you require a detailed report with annotations regarding our views and planning issues arising, I can email you my working version of the Thompson Reuters commentary which itself is publically available. Please email me at ntc@chancellors.com.au if you would like this report and have not yet received a copy.

If you have any specific concerns about how the budget affects you please do not hesitate to contact me. Most changes have July 2017 implementation and can be covered in year-end planning consultations.