# THE FEDERAL BUDGET 2018

## AN OVERVIEW OF CHANGES, PROPOSALS & IMPLICATIONS

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# PROTECTING YOUR SUPER: MORE CHOICES TO MAKE FOR YOUNG WORKERS

Younger Australians and those with low super balances will no longer be forced to take out life insurance as part of their superannuation.

The move is part of the Federal Government's "Protecting Your Super" package, announced in the 2018 Federal Budget. It means members under the age of 25 and those with balances of less than $6000 will need to opt in to insurance cover rather than getting it automatically.

The government says the initiative is designed to protect super from being eroded by insurance premiums. It also includes banning exit fees as well as a 3% cap on administration and investment fees charged on superannuation accounts with balances of $6,000 or less.

Meanwhile, a mandatory consolidation program will require super funds to transfer inactive accounts with balances below $6,000 to the Australian Tax Office (ATO). The ATO will be given powers to reunite those accounts with the member's active account where possible.

A financial advice industry leader says this year's budget will encourage younger people to be more engaged with their super.

"There are proactive choices they have to make, particularly around insurance," they said. "They also need to make choices around consolidating multiple super accounts or the ATO will make that decision for them."

The Association of Superannuation Funds of Australia (ASFA) says opt-in insurance for young people could have unintended consequences, particularly on those in high risk occupations.

"Insurance in superannuation is one of the most cost and tax effective options to provide protection, particularly for the young and low income earners," ASFA CEO, Dr Martin Fahy says. "Many young people have dependents and financial commitments so in the instance of a tragic event occurring, particularly disablement early in life, having insurance in place is extremely valuable."

"Moving to an opt-in model puts insurance coverage at risk for this segment."

The changes are proposed to apply from 1 July 2019.

# 2
# PENSION LOANS SCHEME

From 1 July 2019 every homeowner over Age Pension age will be able to take out a Government–backed loan on the equity of their home to boost their annual income by more than $11,000 for the rest of their lives.

Under its ‘More Choices for a Longer Life’ package, the government has opened the Pension Loans Scheme to all retirees of Age Pension age – not only part-rate pensioners as is currently the case.

The loans scheme is essentially a mortgage which allows retirees to supplement their income by lending against their home equity.

Retirees on a full Age Pension will be able to use equity in their homes to increase the maximum fortnightly income to 150% of the maximum Age Pension, which is about $23,000 a year for individuals. That’s additional income of about $11,500.

Income streams from the loans scheme are non-taxable and not means tested.

Loans only need to be repaid – at an interest rate of 5.25% pa – if the house is sold, or the borrower dies, in which case it is repaid by their estate.

A financial advice industry leader says the new policy – combined with other initiatives announced in this year’s budget – has “fundamental implications on how long funds may last in retirement and how much age-pension individuals receive”.

“Allowing pensioners to tap into the value of their home to top up their income in retirement will influence how long the money may last. How and when you access the scheme and how it works with some of the other measures is complex and highlights the need for quality advice to make sure all retirees make good choices” they said.

# 3

## LIFETIME RETIREMENT INCOME PRODUCTS: IT PAYS TO INVEST IN AN INCOME FOR LIFE

New rules for lifetime income products could help pensioners boost their pay cheque and improve living standards.

From 1 July 2019, means test rules for Age Pensions will be altered to encourage more people to take up lifetime retirement income products – which provide an income for as long as they live – in a move designed to help more retirees ensure they don't outlive their savings.

David Knox, a superannuation industry expert, says under the new means testing rules products that provide longevity protection would be more attractive for retirees who are currently receiving a part Age Pension.

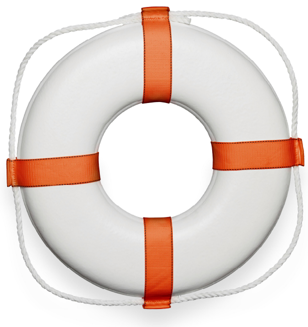
"There will be an immediate increase in the part pension when assets are used to purchase a qualifying product," Dr Knox says. "If a 70-year-old pensioner with $400,000 in assets invested $100,000 in a longevity product they would immediately increase their Age Pension payment by $120 a fortnight."

Under the proposal a fixed 60% of all lifetime product payments will be assessed as income for Age Pension eligibility, and 60% of the purchase price of the product will be assessed as assets, reducing to 30% from the later of age 84 or 5 years after purchase.

The new rules will not apply to products purchased before 1 July 2019.

A leader in the financial advice industry says the new policy – combined with other initiatives announced in this year's budget – has "fundamental implications on how long your funds may last in retirement and how much Age Pension you could be entitled to".

"Those commencing their pension journey now have more complexity in their choices," they said. "That complexity – all those decisions at the point of retirement and further into retirement – really highlight the need for quality advice."



# 4

# SUPER SCHEMES: FOR SAVING UP OR SCALING DOWN

Two super housing schemes – one designed to help those looking to buy their first home, the other to help those scaling down to a smaller one, take effect from 1 July, 2018. Both schemes, announced in last year's Federal Budget, involve using your superannuation.

## First Home Super Saver Scheme

First home buyers can now use their super to save up to $30,000 for a house deposit.

From 1 July, customers can withdraw money saved under the first home buyers' scheme, announced in last year's Federal Budget.

Under the scheme first home buyers can direct up to $30,000 above their compulsory employer contributions, into their super account, for a house deposit.

These extra contributions are capped at $15,000 in a single year and cannot include compulsory employer contributions. They also count towards your $25,000 pa concessional cap. The extra contributions get the same tax benefits of super, with contributions and earnings taxed at 15%, rather than marginal rates. Any withdrawals will be taxed at 30% below your income tax rate and must be used specifically for a house deposit.

Couples, siblings or friends can each access their own eligible contributions to combine them to purchase the same property.

## Downsizing contributions into superannuation

People aged 65 and older who sell their primary home on or after 1 July, 2018 can make a tax exempt one-off contribution of up to $300,000 to their superannuation, from the proceeds.

That also means that couples selling a jointly owned home can contribute up to $600,000 of the proceeds between them, provided total contributions don't exceed the sale price of the property.

Home owners must have owned the home for ten years or more prior to selling it and make a downsizer contribution within 90 days of receiving the proceeds of sale. Downsizer contributions won't be counted under contribution caps but will be taken into account for determining eligibility for the age pension.

Downsizers must proceed with caution. Downsizing contributions could have Centrelink implications. A downsizer's primary residence is not counted against the assets test, but if they sell it and put the proceeds into super, that money is counted. Downsizers will need to weigh up the benefits of adding to super depending on their personal tax situation and Centrelink entitlements. *For full details of the scheme, go to the ATO website*

# 5

# DIVIDENT IMPUTATION: FRANKING MY DEAR, SHOULD WE GIVE A DAMN?

With a Federal Election due in 2019 it's not only government announcements that warrant investors' attention. A fiery debate about 'dividend imputation', which hit headlines in the weeks leading up to the May budget, has left many of Australians scratching their heads.

Federal Labor's plan to scrap dividend imputation cash refunds has been vigorously described as a "brutal tax grab" on retirees and a crackdown on a "tax loophole for millionaires".

Labor leader Bill Shorten says full and part-pensioners, as well as others who receive government allowances, will be exempt from the proposed changes; nevertheless the policy would likely have a significant impact on people who pay little or no tax.

### What is dividend imputation?

Dividend imputation was introduced by the Hawke/Keating Government in 1987 to stop double taxation on company profits. The scheme gives shareholders a credit for the 30 per cent company tax paid before dividends are distributed. Dividends on shares with imputation credits are called 'franked dividends'.

The system was made more generous in July 2000 when the Howard/Costello Government allowed excess franking credits to be paid as a cash refund. Grattan Institute economist Danielle Wood says the rationale behind the more generous scheme was to ensure low-income earners were treated fairly.

"If you believe that everyone should pay tax on company profit distributions at their marginal rate of tax," Wood says, "then you need to provide the refund for people with low incomes."

### How it works

Say an Australian company makes pre-tax earnings of $1 per share. It pays tax at the company rate of 30%, or 30 cents a share, and returns the remaining 70 cents to shareholders as a franked dividend.

The level of benefit you receive depends on your personal marginal income tax rate.

### High marginal tax rate

If you pay tax at the top rate of 47% and own 100 shares in the company, the total amount of tax you owe on the company's earnings is $47. The company has already paid $30 in tax on your 100 shares, so you only owe another $17. The total amount of after-tax income you'll receive from your shares is $53.

Nothing would change for you under the ALP proposal.

### Low marginal tax rate

If your marginal tax rate is at the lower end of the scale, just 21%, and you also own 100 shares, the outcome is quite different. The total amount of tax you owe on the company's earnings is $21. Since the company has already paid $30, you'll receive a refund of $9. Your total after-tax income from your 100 shares is $79.

Under the ALP proposal you would lose that extra $9, unless you're considered exempt.

### Paying no tax

Many retirees or people who earn below the annual tax-free threshold of $18,200 pay no tax at all on their fully franked shares. If you own 100 shares in the same company and your only income is from a self-managed super fund in tax-free pension phase, you would receive a $70 dividend from the company. Because you pay no tax, you also receive a full refund of $30.

Under the ALP proposal, you would lose this $30.

### What is Labor proposing?

Labor wants to abolish cash refunds for unused franking credits, effectively restoring the original tax treatment of dividends.

Shareholders who pay no tax would not be able to claim the 30% share of company tax paid on their dividend. And low-income earners would no longer get a proportion of their taxed dividend back, unless they're considered exempt.

Labor argues that more than 92% of taxpayers receive no cash refund for excess imputation credits and won't be affected at all. They also say cashed-up self-managed super funds (SMSFs) are "a major beneficiary of this practice". According to Labor, 50% of the benefit goes to the top 10 per cent of SMSF balances – with some funds receiving cash refunds of more than $2.5 million a year.

Labor says ending cash refunds will save $59 billion over the next decade and help bring the budget back to surplus. When franking credit refunds were introduced the economic landscape was very different.

"The primary difference is that superannuation in retirement is now tax-free, so we now have a large and growing group of older Australians with quite high levels of wealth that have low taxable incomes," Wood says. "When they first introduced refunds in 2000, the cost to the bottom line was about $500 million a year; today it's about $5 billion and it's estimated to go up to $8 billion in a few years' time."

### Who will Labor's plan impact?

Gordon Mackenzie, senior lecturer at the University of NSW's School of Taxation and Business Law says retirees with SMSFs will be hardest hit.

"The outcome is that SMSFs will be less attractive for tax purposes because they will be denied a refund," Mackenzie says. "But if you've pooled your money in a big super fund with 'taxable people' in it then you can still get the benefits of the imputation credits. So it has created a distortion in the way that super funds are taxed."

# 6

# TAKING CARE OF AGEING BUSINESS

The Federal Government has announced 14,000 new high-level home care packages to help older Australians stay in their own homes for longer.

The new packages will cost $1.6 billion over four years and come on top of an additional 6,000 high-level home care places announced in the mid-year outlook.

Treasurer Scott Morrison also announced a range of smaller funding increases across Aged Care related activities including: $83 million for mental health services in residential Aged Care facilities; $20 million for similar services for seniors living at home; $33 million funding for palliative care in nursing homes; $50 million to improve the quality and safety standards; $145 million boosting support for indigenous, remote and rural areas; and increased funding to address elder financial abuse.

There were also measures to encourage proactive planning behaviours by seniors and families with the introduction of online interactive checks for people aged 45 and 65 years to gauge their skills, finances and health.

A leading superannuation industry expert says "There remains a major discrepancy between the current demand for aged services and existing supply and this is likely to be exacerbated with the ageing population and longevity trends in motion".

"Overall, the Budget measures are positive for senior Australians: they provide financial and non-financial support; help seniors proactively plan for and be in control of their choices and arrangements; as well as take the sting out of needing to contribute more for their own age-related care and living needs," a leading superannuation industry expert says.  "But the 20,000 high-level home care packages announced over the past year is only a fraction of the 100,000 or more eligible Australians who are currently on a wait list for the care they have been assessed as needing."

Louise Biti, Director at Aged Care Steps, said the Budget's additional home care packages were a move in the right direction but also pointed to the shortfall of available places.

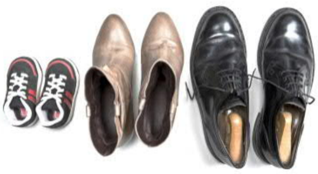
"There will always be more people wanting home care packages than the government can afford to fund, but we need to have more conversations and awareness about home care packages and the Budget will go some way to helping people focus on them," Biti says.

"From a consumer point of view, it's very good that nothing has become more costly but for the ongoing sustainability of the sector, we were gearing up for a lot more."

# 7

# FINDING THE MIDDLE TAX GROUND

Low and middle-income earners were the big winners from planned tax cuts outlined in the Federal Budget, with a dual-income family potentially saving $1,000 a year.



The personal income tax cuts, which delivers immediate tax relief for those earning up to $90,000 a year is part of a three-point plan to overhaul the tax system.

The final part of Treasurer Scott Morrison's seven-year plan would see the 37% tax bracket abolished altogether by 2025 and workers on $41,000 a year paying the same tax rate as someone earning $200,000.

Under part one of the plan, low-income earners with wages of up to $37,000 a year will have their tax offset by an extra $200 on top of established offsets.

Those earning between $37,001 and $47,999 will receive a tapered reduction up to a maximum of $530 a year and those earning between $48,000 and $90,000 will receive the maximum offset of $530. The offsets will be introduced in 2018-19 financial year.

The next stage is to tackle "bracket creep" by raising the 32.5% tax bracket from $87,000 to $90,000 from 1 July 2018, which Morrison says will prevent 200,000 tax payers from creeping into the 37% tax bracket due to something as basic as salary increases aligned to Cost Price Index.

Further threshold changes have been flagged for 2022-23, with an ambitious proposal to abolish the 37% tax bracket altogether from July 2024. That would mean everyone earning between $41,000 and $200,000 will pay a flat tax rate of 32.5%.

Rod Campbell, Research Director at The Australia Institute, says the longer term proposals will be a boon for higher income earners. Campbell also believes that the proposed removal of the 32.5% bracket is trying to have it both ways – "talking up tax cuts" that may never eventuate.

"If the cuts are fully implemented, in 2024-2025 someone on $200,000 receives a tax cut 16 times greater value than someone on $41,000," Campbell says. "Because the tax cuts are so far out, they don't have to deal with that reality."

"Some of our initial numbers, and they're not definitive, mean we're looking at a $140 billion reduction in Government revenue over ten years which has serious effects on provision of services."

The Grattan Institute's Budget Policy and Institutional Reform Program Director, Danielle Wood says it's no surprise the Federal Government is giving away a big chunk of the recent revenue windfall in tax cuts, but says "it's highly unusual to be committing to tax cuts two or three elections away".

"Especially with so much uncertainty around future economic parameters," Wood says. "Let's not forget we haven't seen the surplus yet and the wages forecast is quite buoyant - at mining boom levels."

"The Government is saying that there are savings of around $400 million over four years, which is basically a rounding error. And that implies superhuman spending restraint in the normal programs. They have been successful in showing spending restraint to date but I do wonder how much further they can keep doing that."

# 8

# SUPER INCREASE REMAINS ON TRACK

The Turnbull government has committed to increasing compulsory employer-paid superannuation rates, beginning in three years' time.

The Superannuation Guarantee will increase from 9.5% to 10% on 1 July 2021 and is scheduled to increase in 0.5% yearly increments, hitting 12% by 2025.

David Knox, a superannuation industry expert says increasing the Superannuation Guarantee to 12% will boost Australian's retirement savings and cut future reliance on the age pension.

"As Australians live longer, they will draw an age pension for longer – as a result the Government will need to spend more in pension payments," Dr Knox says. "An increase in the Superannuation Guarantee to 12% will help to offset these increased costs."

The Association of Superannuation Funds of Australia says increasing the Superannuation Guarantee to 12% of salary would result in half of all of Australians living comfortably in retirement by 2050, just over double the current proportion.

"This is a unique social policy achievement that we should view with pride, optimism and confidence for the future," CEO Dr Martin Fahy says.

In 2012, the Gillard Labor government moved to incrementally increase the Superannuation Guarantee from 9% to 12% by 2019. The Abbott government froze the Superannuation Guarantee at 9.5% in 2014, where it has remained.