StrategySteps

2016 Federal Budget

3 May 2016

Contents	Page

Note: The measures outlined in this paper are all currently government proposals. The analysis and interpretation is based on information available in the Budget release which is sometimes quite limited. Further details may need to be released to clarify some aspects and legislation needs to be introduced to make the changes effective (unless otherwise indicated). These announcements could be subject to further change before being enacted or may not be implemented.

1. Economic insight

The foundation of this year's pre-election Budget is "jobs and growth" with the Government positioning the message that it has a solid economic plan to transition the economy from the resource boom to a more diversified economy.

However, the Reserve Bank's decision to cut interest rates by 0.25% to a historical low of 1.75% contradicts the Government's message of a strong Australian economy, particularly by international standards.

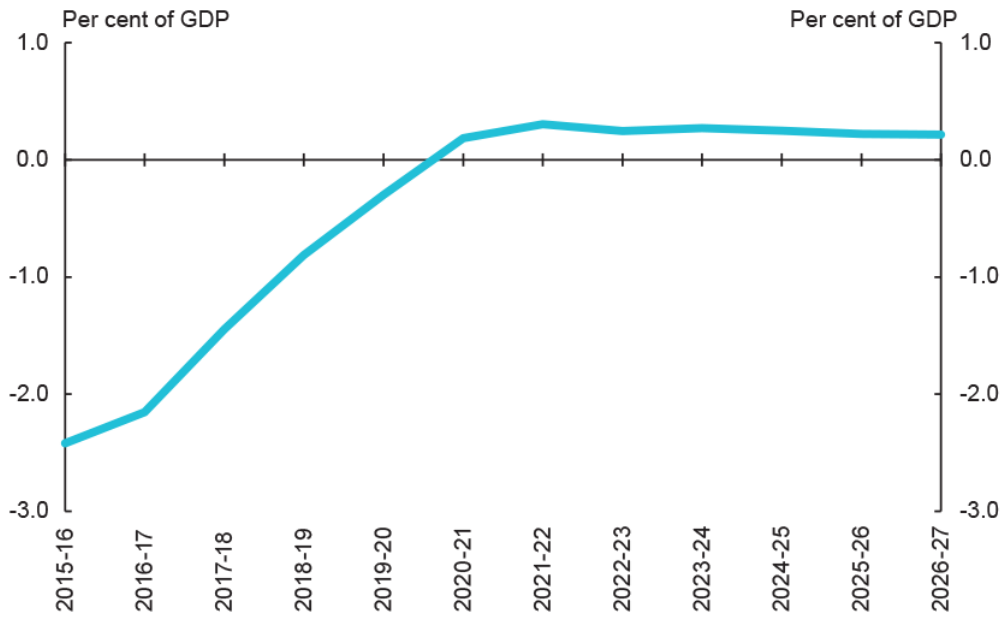
The Federal Budget is based on the following platforms which have implications for the economic and investment outlook:

- Putting in place "jobs and growth" measures aimed at boosting new investment, creating jobs and supporting small companies
- Cutting the company tax rate for small to medium companies to 27.5% from 1 July 2016. It is expected that economic and job growth will be greater from tax cuts to small and medium businesses than to larger companies. The company tax rate will be progressively lowered to 25% for all companies over the next 10 years
- Limiting superannuation tax concessions to the rich and redirecting these to lower income earners and those with lower tax balances
- Controlling spending growth. Government payments as a share of GDP are forecast to decline from 25.8% of GDP in 2016-17 to 25.2% of GDP in 2019-20.

The measures announced aim to create jobs as the mining boom ends and new sources of growth emerge. According to the Budget papers, there were almost 300,000 jobs created in the economy last year, the largest number of jobs created in a single year since 2007.

The Government's view is that a key to higher economic growth is through supporting innovation with a $1.1 billion National Innovation and Science Agenda and other new measures to boost investor confidence and take advantage of the rising Asian middle class and ageing populations to export more services.

The Budget deficit is forecast to continue to fall. The Government forecasts it will deliver a balanced budget surplus eventually in 2020/21. The underlying cash balance is expected to improve from a deficit of 2.4% of GDP in 2015/16 to 0.3% of GDP in 2019/20. This is illustrated in the following graph.



Advice and investment implications

- Small companies with revenue below $10 million will benefit from the company tax cuts from 1 July 2016. The company tax rate will be progressively lowered to 25%.for all companies in 10 years' time. If these tax cuts are legislated, small and medium companies should benefit more than larger companies. This should benefit clients and SMSFs invested in small/medium companies such as unlisted and private companies and private equity with exposure to such companies.
- The Budget changes propose limiting the contributions into super and the amount that can be held in pension phase. These changes could reduce fund flow support for Australian shares by superannuation funds (particularly self-managed super funds) which would affect the growth in share prices. Shares that have been highly sought after by SMSFs such as high yielding companies may be more adversely affected by these changes. On the other hand, the company tax cuts should make Australian companies more globally competitive and thereby attract more funds flow from international investors.
- High net worth investors are likely to seek alternative non-superannuation strategies and structures to provide tax effective wealth accumulation. Investment bonds that are taxed at a maximum rate of 30% are likely to experience an increase in demand. Negative gearing is another key tax management strategy that may also benefit from the superannuation changes. In addition, the interest rate cut announced by the Reserve Bank could see greater interest in residential and other investment property, thereby propping up property prices.

Advice implications of yesterday's Reserve Bank interest rate cut

- The historically low interest rates mean that retirees relying on cash and term deposits to generate income will see their returns fall further. Investors in maturing term deposits may need to accept lower rates to lock in their return or alternatively consider other investments which are likely to involve higher levels of risk. This particularly applies to SMSFs with a large overweight allocation to term deposits and/or cash.

- The search for yield has seen higher yielding securities increase in price which makes them less compelling investments from a valuation perspective. Clients need to be cautious to not overpay for securities in the chase for competitive yields
- Advisers may need to review the strategies and portfolio construction approach for clients relying on secure cash and term deposits to generate the returns and income needed to fund their retirement. Advisers should re-assess the trade-off between the clients' acceptable risk tolerance and the likelihood that their portfolio will grow to satisfy their objectives
- This rate cut may be welcome news for accumulators with debt especially a mortgage. Debt consolidation strategies may be considered to take advantage of lower interest rates. Advisers may also encourage clients with debt to reconsider their personal budgets and the clients' ability to make higher payments to potentially reduce the life of their loan.

The Economic outlook

This Budget provided the following economic forecasts:

	Last Year 2015/2016	**This Year 2016/2017**	**Next Year 2017/2018**	**And 2018/2019**
Economic Growth (% change)	2.5 (2.75)	2.5 (3.25)	3.0 (3.50)	3.0 (3.50)
Wages (% change)	2.25 (2.50)	2.50 (2.75)	2.75 (2.75)	3.25 (3.25)
Inflation (%change)	1.25 (2.50)	2.0 (2.50)	2.25 (2.50)	2.50 (2.50)
Unemployment (%change)	5.75 (6.50)	5.50 (6.25)	5.50 (6.0)	5.50 (5.75)

* ( ) Numbers in brackets are the forecasts provided in the 2015/2016 Federal Budget

There have been significant changes to the economic forecasts compared to last year's figures. This raises the question - are the new assumptions about the Australian economy (economic growth, wages, inflation and unemployment) reasonable? This is addressed below.

Economic growth (GDP)

In last year's budget, Treasury expected the Australian economy to grow by 3.25% in 2016/2017. It now expects the economy to grow at a slower rate of 2.5% which is below-average pace over the medium term. Furthermore, economic growth has been revised down in the 2018 and 2019 financial years. It is worth noting the RBA expects the economy to grow between 2.5% and 3.5% in 2016/17 (relative to the 2.5% forecast in this Budget) and between 3% and 4% in the 2018 financial year (relative to the 3.0% forecast in this Budget).

The forecasts provided in this Budget are not unrealistic even if mining investment falls further as large resource-related projects are completed and few new projects commenced. However, they seem to rely heavily on consumer's responsiveness to spending and demand for our exports by global markets.

The combination of low interest rates and growth in employment should lead to a pickup in household incomes and demand. Consumption growth should increase to levels a little above its longer-term average which should support economic growth.

Treasury's inflation forecast numbers have been revised down, suggesting inflation is likely to stay low over the medium term.

Inflation will continue to remain at the bottom end of the RBA's target range of 2-3% over the next couple of years given the following:

- Wage growth is not expected to increase due to spare capacity in the labour market and the pressure on employers to contain costs
- Prices of non-tradable items such as services are forecast to pick up gradually but remain below the RBA's target range of 2-3%.
- The prices of tradeable items are heavily influenced by changes in the exchange rate. The Reserve Bank prefers a lower Australian dollar. If it eventuates, a fall in the Australian dollar should lead to an increase in import prices, which is likely to be passed on to consumers as higher prices.

Headline inflation has been low over the past year or so, partly as a result of factors that are likely to have a temporary effect such as lower fuel prices and lower utility prices. Some businesses have already passed on the lower costs e.g. airlines with lower airfares.

The forecast is for inflation to increase modestly to just over 2%. This forecast is reasonable as the effect of the temporary factors putting downward pressure on inflation dissipates. A further increase in the tobacco excise later in 2016 is expected to contribute a bit less than ¼ percentage point to headline inflation, but to have little effect on underlying inflation.

The unemployment rate has been revised down slightly over the medium term

The unemployment rate has surprised many and fallen over the last 12 months. A concentration of economic activity in labour-intensive service sectors, such as household services, may help to explain the strength in employment growth over 2015 despite below-average GDP growth.

Low growth of wages also appears to be consistent with the forecast for more employment growth. These factors are likely to continue to support employment growth for a time. In addition, leading indicators of labour demand, such as job advertisements and vacancies, remain on an upward trend and point to greater employment growth.

In the next 12 months, while employment growth is expected to slow somewhat from the rapid pace seen in the December quarter 2015, it is forecast to remain strong enough to reduce the unemployment rate.

What could go wrong?

The forecasts by Treasury are based on a range of assumptions. A key uncertainty affecting the forecasts is the outlook for growth in China and the effect of their high levels of debt. Ultimately, this has implications for commodity demand and commodity prices, and hence forecasts for the terms of trade. Domestically, the outlook for the labour market and the income growth of households and the changes to their wealth from the housing market are important sources of uncertainty.

2. Superannuation contributions

The clear messages from this year's Budget changes to superannuation indicates the Government's view that wealthier people are using superannuation to accumulate more than they need for retirement and more flexibility is needed for people to choose when and how they make contributions to superannuation.

The Government is attempting to reduce the cost of tax concessions to super by limiting the amount that can be contributed as well as the tax exemptions in retirement.

Clients with lower balances and/or lower levels of income will gain greater flexibility. Clients with higher balances and/or incomes may choose to seek alternative non-superannuation investment options that also provide tax advantages.

a) Changes to concessional contribution caps

From 1 July 2017, the concessional contributions (CC) cap will be reduced to $25,000 per annum (indexed) for everyone, regardless of age. The cap is currently $30,000 per annum under age 50 and $35,000 per annum at age 50 and over.

Members of defined benefit funds will also be affected. Notional (estimated) and actual employer contributions will both be included in the CC cap for members of unfunded defined benefit schemes and constitutionally protected funds. Existing grandfathering rules will apply for anyone who was a member of a funded defined benefit scheme as at 12 May 2009.

On the positive side, clients who have total superannuation savings of less than $500,000 who do not fully utilise the cap each year can carry forward the unused cap on a rolling five-year basis starting from 1 July 2017.

Example

Jenny's superannuation balance is $200,000.

She goes on maternity leave and only uses $10,000 of her concessional contribution cap in 2017/18 which allows her to carry forward the unused portion ($15,000) for up to five years (ie until 2021/22).

When Jenny returns to work in 2018/19 she can make concessional contributions up to $40,000 without creating an excess (ie $25,000 annual limit plus $15,000 unused limit that was rolled over).

Advice implications:

The reduction in the concessional cap reduces the ability of clients to salary sacrifice or make personal deductible contributions.

Clients who wish to save higher amounts each year may need to consider tax-effective non-super options such as insurance bonds or negative gearing arrangements. It may also encourage some

clients to consider limited recourse borrowing arrangements (LRBAs) inside a self-managed superannuation fund as a way of boosting the earnings inside superannuation.

The reductions in caps do not take effect for another year so clients should consider maximising the higher caps for 2015/16 and 2016/17.

The winners of the rollover measure include clients with lower superannuation balances who do not have the ability to maximise contributions every year. This may include:

- Women and carers with broken work patterns,
- People with volatile incomes, such as small business owners
- People who are on a career progression and expect promotions in the coming years.

Effective date – 1 July 2017

b) Lifetime non-concessional contributions (NCC) cap

The annual non-concessional contribution (NCCs) caps and bring-forward rule will be replaced with a $500,000 lifetime cap. This cap will be indexed to average weekly ordinary time earnings (AWOTE).

The lifetime cap will apply to all NCCs made on or after 1 July 2007 with immediate effect. If contributions made before budget night (7.30pm on 3 May 2016) exceed this cap excess tax will not apply. However, excess contributions made after this time (and associated earnings) will incur excess contributions tax if not withdrawn.

Members of defined benefit schemes and constitutionally protected funds will also be affected by the lifetime cap. If the cap is exceeded they can continue to make contributions but will be required to withdraw an equivalent amount (including proxy earnings) from any accumulation accounts each year. The amount that can be withdrawn from the accumulation account is limited to the NCC in that account.

The government is yet to determine the administrative arrangements including implications where withdrawals are not possible.

Advice implications:

This is a major change which significantly limits a client's ability to accumulate wealth inside superannuation. The lifetime limit of $500,000 is less than three years of the current cap.

Higher net wealth clients may wish to consider other tax-effective investment options such as insurance bonds or negative gearing once they have reached the lifetime cap.

The lifetime limit creates greater flexibility for clients to choose when and how much to contribute but it will add administrative complexity for advisers. Before giving advice on NCC strategies you will need to check the available limit for the client.

The lifetime cap now limits the ability to use the cash-out and recontribution strategy for a client who has triggered a condition of release. Before recommending this strategy you should check the available lifetime cap.

Effective date – immediately and applies to all NCC made since 1 July 2007

c) Contribution work test abolished

The contribution work test will be abolished from 1 July 2017 allowing everyone under age 75 to make personal contributions to super or have a spouse contribute on their behalf.

Under current rules, a client age 65<75 needs to meet the work test before making a personal contribution. This requires gainful employment for at least 40 hours within 30 consecutive days in the financial year before making the contribution and spouse contributions had to stop at age 70.

Only mandated employer contributions can be made from age 75.

Advice implications

This change provides greater flexibility and simplicity. The contribution eligibility ages will be brought into line for personal, employer and spouse contributions.

It will also allow clients who are preparing for retirement to consider downsizing their home and contributing surplus amounts into super or who receive inheritances to use super (subject to the limits imposed by contribution caps, particularly the new non-concessional lifetime limit).

Effective date – 1 July 2017

d) Increased eligibility for spouse contribution tax offset

Clients who have a low-income spouse may be encouraged to make spouse contributions with an increase in the eligibility income threshold for the tax offset.

From 1 July 2017 the full tax offset is proposed to be available if the receiving spouse has income up to $37,000 (increased from $10,800).

The offset is still limited to $540 and is calculated as an 18% tax offset on the first $3,000 of non-deductible contributions made on behalf of an eligible spouse. Spouse contributions count towards the lifetime non-concessional contribution cap.

Example

John and Cathy are married. John earns $150,000 per annum and Cathy earns $28,000 per annum.

John makes a $3,000 contribution into Cathy's fund in 2016/17 but does not qualify for a tax offset. He makes a further $3,000 contribution in 2017/18 and qualifies for a $540 tax offset due to the higher eligibility income thresholds.

If Cathy's income in 2017/18 is $39,000 (including reportable fringe benefits and reportable employer superannuation contributions) he will qualify for a reduced offset of [$3,000 - ($39,000 - $37,000)] x 18% = $180

Effective date – 1 July 2017

e) Tax deductions for personal contributions

Everyone under the age of 75 will be able to choose to claim a tax deduction for personal superannuation contributions made from 1 July 2017 regardless of employment status (ie. full-time employees, self-employed, not employed).

Currently, a deduction can only be claimed by clients who are self-employed or substantially self-employed (ie less than 10% of their income is attributable to employment-related activities).

These contributions count towards the annual concessional contribution cap.

Advice implications

The change provides everyone under age 75 with an equal opportunity to contribute to superannuation and fully use the concessional contribution cap regardless of employment status.

It may create greater opportunities for end of financial year strategies to manage tax liabilities where clients have available cash to invest and have not fully used the annual CC cap already or have unused caps rolled over from previous years.

It also means employees will no longer have to make salary sacrifice arrangements with employers to gain tax concessions. Clients may be more inclined to limit employer contributions to just super guarantee (SG) contributions and claim personal deductions for additional contributions to avoid negative outcomes from lowering the cash component of salary packages.

Effective date – 1 July 2017

f) Low income superannuation tax offset

A low income superannuation tax offset (LISTO) has been reintroduced from 1 July 2017 for clients with adjusted taxable income up to $37,000 per annum.

The LISTO is a refund of contributions tax paid on concessional contributions and is capped at $500 per annum. It will be paid into the client's superannuation account as a non-refundable tax offset.

This new measure replaces the low income superannuation contribution (LISC) when it is abolished from 30 June 2017.

Advice implications

Clients on low incomes will no longer face a higher tax rate on super contributions than would be paid on salary or other income.

Combined with the increased ability to make contributions up to age 75 and the ability for everyone to claim tax deductions for contributions, this may encourage clients on lower incomes (including retirees under age 75) to top up super.

Effective date – 1 July 2017

g) Reducing the Division 293 threshold for high-income earners

High-income earners currently pay an additional 15% tax on concessional contributions (CC) which take total income over the $300,000 threshold. This is called 'Division 293 tax' based on the legislative provision that outlines the extra tax.

The income threshold is proposed to be cut from $300,000 to $250,000 per annum from 1 July 2017 to limit the concessions available to higher income earners. This will increase the number of people liable for the additional tax.

The flat rate tax on super means that higher income earners gain a greater advantage from concessional contributions as shown in the table below (using current rules).

Taxable income	Marginal tax rate (includes 2% Medicare)	Effective tax rate on super contributions	Tax benefit
$0 to $18,200	0%	0%	Nil
$18,201 to $37,000	21%	0%	21%
$37,001 to $80,000	34.5%	15%	19.5%
$80,001 to $180,000	39%	15%	24%
$180,001 to $300,000	49%*	15%	34%
$300,001 +	49%*	30%	19%

*Includes the 2% temporary budget repair levy which will be abolished from 1 July 2017.

The $250,000 threshold will also apply to members of defined benefit schemes and constitutionally protected funds. Existing exemptions (such as State higher level office holders and Commonwealth judges) will be maintained.

Advice implications:

Cutting the threshold to $250,000 will catch more taxpayers with the higher 30% contributions tax and reduce the tax benefits on concessional contributions.

Despite this change, the 30% tax applied to concessional contributions is still less than the marginal tax rate on earnings so contributing to super remains attractive. But with the lower $25,000 concessional contribution there will be limited scope for these clients to make optional concessional contributions.

For example, if a client earns $250,000 and his/her employer pays the 9.5% SG on full salary this is an annual employer contribution of $23,750 which has almost fully utilised the new lower cap.

Clients on higher incomes with disposable income may look for alternatives outside superannuation or top up their spouse's superannuation (and potentially receive a tax offset).

Effective date – 1 July 2017

h) Anti-detriment abolished

In an anticipated change, anti-detriment payments will cease to be paid from 1 July 2017.

Currently, upon the death of a member, some superannuation funds pay an extra anti-detriment amount to eligible beneficiaries on top of the deceased member's account balance. It is essentially a refund of contributions tax that has been paid by the deceased member.

Advice implications:

This change will not impact a client's decision to contribute to superannuation but does mean they don't need to consider whether a fund offers the anti-detriment payments when selecting a fund. It also brings self-managed funds (SMSFs) back to an even footing as most SMSFs were unable to pay an anti-detriment payment.

The anti-detriment payment conflicted in some situations with the cash-out and recontribution strategy, as that strategy had the potential to reduce the amount of the anti-detriment payment, which was usually based on the amount of taxable component in the fund at death.

Once the anti-detriment is abolished this conflict will no longer apply, but the ability to use the cash-out and recontribution strategy going forward is limited by the lifetime non-concessional contribution cap.

Effective date – 1 July 2017

3. Income streams

Tax concessions on income streams have been reduced, which has allowed the pension payments and withdrawals from superannuation by people over age 60 to remain tax-free. The government has also endorsed making changes to legislative rules to allow further innovations in retirement income stream products.

a) Taxing TTR earnings

Earnings in the pension phase of superannuation are tax-exempt however, this will no longer apply to transition to retirement (TTR) pensions from 1 July 2017.

The original purpose of TTR pensions was to encourage people to transition towards retirement by reducing their work hours and allowing superannuation pensions to start to supplement reduced employment income.

But in reality many TTRs have been started as a tax planning strategy using salary sacrifice and the exempt status of pension income. From 1 July 2017 tax will be applied to the earnings derived in a TTR pension.

In addition, clients will not be able to elect for payments to be taxed as lump sums rather than as pension payments to gain a better tax outcome.

Advice implications:

From 1 July 2017, 15% tax will be applied to the earnings derived in a TTR pension and combined with the lower concessional contribution caps these strategies are likely to be less effective and less popular.

Clients with existing TTRs may wish to maintain them until the changes take effect (and legislation is passed). At that point they can:

- Convert to a normal account-based pension if a condition of release has been met
- Commute and roll back to the accumulation phase of superannuation
- Continue the pension if it suits their circumstances.

A review of all clients with TTRs will be required before 1 July 2017, although note that legislation is still required to be passed. You should consider the costs and implications carefully before setting up any new TTRs that may only provide up to 12 months of benefits.

Effective date – 1 July 2017

b) Pension transfer cap of $1.6 million

From 1 July 2017, the maximum amount of superannuation that a person can transfer into pension phase is limited to $1.6 million.

Clients who are already in pension phase before 1 July 2017 will be required to transfer any balance above $1.6 million back into accumulation phase. Clients who are starting pensions from 1 July 2017 cannot roll more than $1.6 million into the pension phase (in total), but the balance rolled over can grow over $1.6million due to earnings without penalty.

If this cap is exceeded an excess tax will apply. Penalty tax will also apply to earnings accumulated on the excess amount.

Individuals who are members of defined benefit schemes will also be affected with tax adjustments applied to pensions over $100,000.

Advice implications:

This is effectively a reversion back to reasonable benefit limit days. However, under this measure the rules limit the tax-free benefits generated from pension phase but do not limit the amount that can be saved in accumulation phase. This is limited by changes to contribution caps.

High net worth clients who have pension balances in excess of $1.6 million could choose to leave savings in the accumulation phase of superannuation where tax on earnings is applied at 15% or withdraw to invest outside superannuation.

Advice strategies will need to consider the tax implications and comparisons inside or outside superannuation.

Effective date – 1 July 2017

4. Personal taxation

Only minor changes were made to personal taxation, and many people will be relieved to know that no changes have been proposed to negative gearing.

a) Personal tax cuts

The middle income tax threshold will be increased from $80,000 to $87,000 from 1 July 2016. This is the point where the 37% marginal tax rate cuts in.

This change is made to counteract the impact of 'bracket creep' caused by inflationary impacts on wages. The threshold change creates a small tax saving for people with income over $80,000.

2015/16 financial year		2016/17 financial year	
Income levels	**Tax rate**	**Income levels**	**Tax rate (excluding Medicare)**
$0 – $18,200	Nil	$0 – $18,200	Nil
$18,201 – $37,000	Nil + 19% for each $1 over $18,200	$18,201 – $37,000	Nil + 19% for each $1 over $18,200
$37,001 – $80,000	**$3,572 + 32.5% for each $1 over $37,000**	**$37,001 – $87,000**	**$3,572 + 32.5% for each $1 over $37,000**
$80,001 – $180,000	$17,547 + 37% for each $1 over $80,000	$87,001 – $180,000	$19,822 + 37% for each $1 over $87,000
$180,001+	$54,547 + 47%* for each $1 over $180,000	$180,001+	$54,232 + 47%* for each $1 over $180,000

* Includes 2% Temporary Budget Repair Levy on taxable income over $180,000 (1 July 2014 to 30 June 2017)

Example

Jenny has taxable income of $79,000 in 2015/16. Tax of $18,802 (including Medicare levy) and her top marginal tax rate is 32.5%.

In 2016/17, her salary increases to $86,000. Instead of being forced into the 37% tax bracket, Jenny will remain in the 32.5% marginal tax bracket and her total tax including Medicare is $21,217.

The change in thresholds has saved her $270 in tax (ie $6,000 at 4.5%).

Advice implications:

Small business owners may have limited salaries to $80,000 per annum to stay around the 30% tax mark which is comparable to company tax rates. These clients may wish to review salary arrangements and consider increasing salaries to $87,000 if appropriate.

The marginal tax rates on income above $37,000 are higher than the company tax rates, particularly for eligible small companies. Clients may consider setting up investment companies to hold investments however, this is really only a tax deferral strategy as taking money back out of the company will impact their personal taxable income. Companies also do not benefit from capital gains tax discounts except on eligible business assets.

Effective date – 1 July 2016

b) Medicare levy thresholds

Each year's Budget announces the new thresholds for exemption of Medicare levy. The thresholds announced for 2015/16 are shown below.

	No Medicare if taxable income is equal to or less than:
Individuals	$21,336
Pensioners eligible for SAPTO	$33,738
Couple (combined)	$36,001
Additional for each dependent child/student	$3,306

Effective date – 2015/16 financial year

c) Freeze on Medicare Levy Surcharge and private health rebate

Indexation of the income thresholds for the Medicare Levy Surcharge and Private Health Insurance Rebate remain frozen for a further three years from 1 July 2018.

Effective date – 1 July 2018

5. Company tax

a) Definition of small business

Tax concessions for small businesses are dependent on the entity meeting the definition of a small business based on annual turnover.

Currently the entity needs to have annual turnover of $2m or less. This will be increased to $10m from 1 July 2016.

Small business entities that meet this test may qualify for:

- The lower small business corporate tax rate – reducing to 27.5% from 2016/17
- Simplified depreciation rules (subdivision 328-D of ITAA97) including the ability to instantly write-off balances up to $20,000 until 30 June 2017
- Simplified trading stock rules (subdivision 328-E of ITAA97)
- Options to account for GST on a cash basis and pay instalments calculated by the ATO
- FBT exemption for portable electronic devices and immediate deduction of professional expenses.

It is important to note that the increased threshold will not apply when determining eligibility for small business CGT concessions. This will still use the $2m annual turnover test or the maximum net asset value test. Eligibility for the unincorporated small business tax discount will apply a $5m threshold test.

Advice implications

This measure will allow more small-medium businesses to access tax concessions to encourage development and growth.

Effective date – 1 July 2016

b) Reduction in company tax rates

Australia currently has one of the highest company tax rates in the OECD and the Asia-Pacific region at 30% (or 28.5% for eligible small companies). This rate is proposed to be progressively reduced to 25% over the next 10 years for all companies.

The reduction will apply through two measures:

- Increasing the annual turnover threshold to qualify for the lower small business company tax rate, and
- Reducing the company tax rate.

Large companies will not benefit from lower rates until the 2024/25 financial year but the increase in the turnover threshold will see an increasing number of medium size companies qualify for the lower small business tax rate. The reductions are shown in the table below.

Financial year	Company annual aggregated turnover	Tax rate
2015/16	< $2m ≥ $2m	28.5% 30%
2016/17	< $10m ≥ $10m	27.5% 30%
2017/18	< $25m ≥ $25m	27.5% 30%
2018/19	< $50m ≥ $50m	27.5% 30%
2019/20	< $100m ≥ $100m	27.5% 30%
2020/21	< $250m ≥ $250m	27.5% 30%
2021/22	< $500m ≥ $500m	27.5% 30%
2022/23	< $1b ≥ $1b	27.5% 30%

2023/24	All	27.5% 30%
2024/25	All	27%
2025/26	All	26%
2026/27 onwards	All	25%

Franking credits will be distributed in line with the rate of tax paid by the company making the distribution.

Advice implications

The lower tax rates may help to increase the profitability of small businesses to help them with cashflow. This may create opportunities to release cashflow for investment (inside or outside the business) or to cover insurances (such as buy/sell funding).

The lower tax rates for larger companies when applied may increase the profits available to pay dividends but the franking credits will also be lower. This may reduce the value to investors on lower marginal tax rates and increase the additional tax payable by those on higher tax rates. However, this change is not expected to overly impact or change investor behaviour over the short term.

c) Increased tax discount for unincorporated small businesses

Many people operate businesses as unincorporated entities – such as sole traders, partnerships and trusts.

Small business companies qualify for a lower company tax rate but unincorporated entities with an annual turnover of less than $5m (up from $2m) may instead qualify for a tax discount. In line with changes to the company tax rate, this discount will be increased over the next 10 years from 5% to 16% as shown in the table below.

Financial year	Tax discount
2015/16	5%
2016/17 to 2023/24	8%
2024/25	10%
2025/26	13%
2026/27 onwards	16%

The maximum discount remains capped at $1,000 per individual in each year.

Advice implications

This measure will provide a tax concession to more people operating small businesses that are unincorporated. However, the reductions in company tax rate may see more clients choose to set up companies to run their businesses.

Effective date – 1 July 2016

d) Taxing multinational companies

Global companies that use related companies to shift profits overseas may be hit with a 40% diverted profits tax (DPT). This will apply to arrangements that:

- Result in foreign tax paid on the income being less than 80% of the tax that would have been paid in Australia
- Are an artificial arrangement designed to reduce tax payable
- Do not have substantial economic substance.

This measure will apply to companies with global annual revenue of $1b or more that are either an Australian resident or have a permanent establishment in Australia. However, if the Australian annual turnover is $25m or less they will be exempt unless it is an artificial arrangement.

If the ATO issues a DPT assessment, tax of 40% will be payable on the diverted profits amount. This offset will be reduced by any Australian withholding tax paid but not be any foreign tax paid. Interest penalties will also be applied.

Advice implications

Nil for clients. Only impacts large companies seeking to avoid Australian tax.

Effective date – 1 July 2017

e) Encouraging early-stage investors

The 2015 Mid-Year Economic and Fiscal Outlook included tax incentives to encourage investment in innovative start-up companies that:

- Had been incorporated within the previous three years (but not listed on a stock exchange)
- Are undertaking an “eligible business”, and
- Had expenditure of less than $1m in the previous year and income of less than $200,000.

These concessions include a 20% non-refundable tax offset and capital gains tax concessions.

Following consultation with industry modifications have been made to those announcements so that the capital gains tax exemptions will apply if the investment is held for at least 12 months (rather than three years). The investors must not be affiliated with the business and the investment amount for non-sophisticated investors to qualify for the tax offset will be limited to $50,000 or less per year

6. Social security and health reforms

No major changes have been announced to the eligibility rules for social security (or Veterans' Affairs) welfare payments. However, the 1 January 2017 reductions to the assets test which have already been legislated from last year's Budget are soon approaching and many welfare recipients will see payments reduced or lost as a result.

a) Removal of rental income exemption

In the 2015 Mid-Year Economic and Fiscal Outlook (MYEFO) a proposal was included to amend the Centrelink/DVA means-test rules for residents of aged care who rent out their former homes.

This measure was reconfirmed in the Budget. The change will impact residents moving into care from 1 January 2017 and brings the assessment rules back into line with the aged care means-test rules that apply from 1 January 2016.

Rental income derived on the former home will be included as assessable income in the pension income test assessment and the full value of the home (not just the capped value) will become an assessable asset.

This measure has not yet passed as legislation.

Advice implications

The inclusion of rental income is likely to reduce pensions under the income test but as the assets test is usually the more dominant test this is not likely to be a major concern for most clients.

The inclusion of the home value in the assets test will have a greater impact and may make it more difficult for some clients to retain their home after moving into residential care. Details on how this asset test change interacts with the two-year exemption rule are still to be determined once legislation becomes available.

If legislated, this change will heighten the importance of planning ahead for the costs of aged care.

Effective date – 1 January 2017

b) Removal of clean energy supplement

When the carbon tax was abolished welfare concessions such as the clean energy supplement stayed in place, although this amount is no longer indexed and is set at $14.10 per fortnight for a single person and $10.60 per fortnight for a member of a couple.

From 1 July 2017, new applicants of Social Security and Veterans' Affairs payments will not receive this additional payment.

Advice implications:

This will see a different payment rate applied to welfare recipients who qualify for payments before or after 1 July 2017. Over time, the real value of the energy supplement is diminishing.

Effective date – 1 July 2017

c) Other welfare measures

- Approximately 90,000 people currently receiving a Disability Support Pension (DSP) will be subject to annual reviews over the next three years to determine their ability to work and may be moved to alternative payments such as Newstart if they no longer meet the requirements for a DSP.
- The Australian and New Zealand Social Security Agreement will be reviewed and updated for changes to residency laws in each country.
- Students receiving welfare payments will automatically qualify for the Health Care Card and will not need to submit a separate application. The means testing rules will also be aligned with other welfare payments.
- Backdating of Carers Allowance will be restricted and the allowance will only be payable from the date an application is submitted.
- The 2015/16 Budget included changes to child care support. The new Child Care Subsidy and the Additional Child Care Subsidy will now be deferred by one year until 1 July 2018 to allow the passing of Family Tax Benefit reforms that were being implemented to help fund the child care reforms.

d) Other health measures

- Children and adults covered by a concession card will be eligible to access the Child and Adult Public Dental Scheme.
- Fees under the Medical Benefits Schedule (MBS) for all services by general practitioners, medical specialists, allied health service providers and other health providers were frozen under a previous Budget. This freeze has been extended by a further two years until 30 June 2020.

Advice implications

The freeze may place further cost pressures on medical service providers and could be reflected in higher prices and/or reductions in access to bulk billing services.

7. Aged care

No changes were announced that will directly impact clients or the contributions they pay towards the cost of their aged care. However, changes were made to government funding for service providers and this may put pressure on costs.

a) Changes to ACFI and funding

The government subsidy paid to a residential care provider for each resident is based on an Aged Care Funding Instrument (ACFI) assessment. This uses a scoring matrix to assess the care needs of a resident against a funding schedule. The result is the cost of care. This cost of care is then shared between the Federal Government (as a subsidy) and the resident (as a means-tested fee if applicable).

The government is concerned by what it sees as an unexpected “blow-out” in the ACFI subsidies and the pressure this is putting on government expenditure.

As a result, changes will be made to the scoring system which are expected to reduce subsidies by over $1.2 billion across the next four years.

Advice implications:

This change may reduce the revenue generated by residential service providers and put more pressure on their operational costs – which could also impact the quality of services provided.

We have already started to see service providers looking at ways of introducing new charges (such as administration fees, higher additional service fees, capital refurbishment fees) and with further cuts to ongoing revenue these practices may continue to expand. This could increase the overall costs of accessing care for residents.

It is important that residents and their families check Resident Agreements carefully to determine the full range of costs charged.

It will also become more and more important for clients to plan ahead and to include funding for aged care in their retirement plans as early as possible.

Effective date – 1 July 2016

b) Increased funding for quality reviews

An additional $10.1 million will be provided to the Aged Care Quality Agency to increase its capacity to undertake unannounced compliance visits to residential care services. This measure aims to improve the quality of care service standards and identify potential problems earlier.

Effective date – 1 July 2016