FEDERAL BUDGET ANALYSIS - MAY 2014

May 2014 Federal Budget

The Australian government unveiled its annual budget yesterday evening on Tuesday 13 May 2014. The Treasurer, Mr Joe Hockey, said he saw his main task as being to "fix the budget". The deficit currently stands at $49.9bn, and it is projected to fall to $29.8bn next year then to $2.9bn by 2017/18. A range of cost-cutting measures are proposed, notably tightening up eligibility for and slowing indexation of many welfare payments, and the introduction of a 2% levy on high income earners. Key spending measures include the creation of a Medical Research Endowment Fund to be funded from a GP visitation charge of $7, defence spending to grow to 2% of GDP within a decade, and more spending on infrastructure (with a $11.6bn growth package proposed).

In our analysis we have focused on budget announcements that may affect your financial planning strategy or investments. It is important to bear in mind that these announcements have not yet been legislated and we note that to pass in the Senate the government will need the support of six of the record 18 crossbench senators. In addition, the information in this update is general – please contact us if you would like to discuss your specific situation in more detail.

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1 ECONOMY AND MARKETS

1.1 Summary

The Treasurer, Mr Hockey, has handed down the 2014-15 Federal Budget with a forecast deficit of $25.9 billion ($29.8 billion on a cash basis). This Budget is part of the government's Economic Action Strategy to "repair the budget and build a strong and prosperous economy". The government's stated aim is to redirect taxpayers' dollars from spending that is consumed today to productive investment for tomorrow.

Key treasury forecasts

FINANCIAL YEAR	GDP % (CHANGE)	INFLATION % (CHANGE)	UNEMPLOYMENT % (CHANGE)	FISCAL POSITION (DEFICIT / SURPLUS)	
				($bn)	% of GDP
2014-15	2.50	2.25	6.25	-25.9 (-$29.8 on a cash basis)	-1.6
2015-16	3.00	2.50	6.25	-12.2	-0.7
2016-17	3.50	2.50	6.00	-6.6	-0.4
2017-18	3.50	2.50	5.75	1.0	0.1

1.2 Breakdown

The budget delivered few surprises with most policy initiatives consistent with expectations. Welfare for low income earners and middle income families appears to be the most heavily impacted as the government attempts to balance the budget over the next 4-5 years. There will also be a temporary 2% levy placed on incomes above $180,000 for the next three years. Cuts to health and education may prove to be the most critical spending cuts, as this will place pressure on the state governments, which in turn will likely see them lobby for an increase in the GST.

Key measures (over 4 years)

SPENDING	$ BILLION
INFRASTRUCTURE (NEW INVESTMENT)	11.600
BUSINESS (INDUSTRY SKILLS FUND)	0.476
EMPLOYMENT (OVER 50's - RESTART)	0.304
*MEDICAL RESEARCH FUTURE FUND	20.000

SAVINGS	$ BILLION
FAMILY WELFARE	Not disclosed
EDUCATION FUNDING CUT	Not disclosed
FOREIGN AID	7.000
PUBLIC SECTOR CONSOLIDATION	Not disclosed
SOCIAL ASSISTANCE (PENSION)	1.100
HEALTH (DOCTOR, HOSPITAL CO-PAYMENT & PBS MEDICINES)	21.300*

**savings from doctor and hospital co-payment charge used to fund MRFF.*

1.3 Analysis

The government's economic outlook is softer than recent RBA forecasts. In 2014/15, the government is forecasting real GDP growth of 2.50%, reflecting a smaller trade balance that more than offsets its stronger expectation for domestic demand. In 2015/16, the government's GDP growth forecast is a little stronger (3%) due to an anticipated improvement in domestic demand. The government expects unemployment to rise to around 6.25% by mid-2015, before easing to around 6%. The government and RBA share very similar views on the outlook for underlying inflation, although the RBA sees larger price pressures in the near-term. Each expects inflation to remain well within the RBA's 2-3% target band over the forecast horizon. The structural adjustment occurring in the economy at present, with the decreasing contribution from mining, remains a real risk to the outlook.

While reductions in government spending can create a negative drag on the economy, the proposed cuts are mild and should have little impact on overall economic growth. Analysts expect the net impact to be between 0.1% and 0.3% in 2014-15. The corporate sector has largely been spared in this budget, however there may be some negative impact on businesses as the reduction in disposable income across the board may reduce spending and consumer confidence. Overall, the budget appears to be a solid attempt to repair Australia's fiscal position while remaining wary of the potential negative impact of government spending cuts on economic growth. Rating agencies have re-affirmed that Australia's AAA rating/stable outlook is not affected.

1.4 Impact on markets

Investment markets were little changed today, with most of the measures (as usual) having been leaked in the lead up. Looking ahead, we do not expect the impact on markets to be material as the overall cuts to the domestic economy are modest. Equities should be able to shrug off any fiscal drag as it will likely be counterbalanced by the expectation that the Reserve Bank of Australia will leave interest rates unchanged during 2014. Companies exposed to infrastructure (particularly roads) should benefit while companies reliant on discretionary spending may suffer given the welfare cuts will likely reduce disposable incomes. Fixed income markets should also be little impacted with markets still expecting the RBA to be on hold until mid-2015. It is more likely that market movements will be driven by offshore news emanating from China (growth transition) and the US (monetary policy).

2 TAX

The changes made to tax in this budget were telegraphed well in advance. The Temporary Budget Repair Levy is the headline measure, and as has been the case in many recent budgets, there were announcements of threshold freezing and changes to indexation for various measures noted below.

2.1 Personal tax rates (excluding the Medicare Levy)

TAXABLE INCOME RANGE	TAX PAYABLE IN 2014/15
$0 – $18,200	Nil
$18,201 – $37,000	Nil + 19% on amount over $18,200
$37,001 – $80,000	$3,572 + 32.5% on amount over $37,000
$80,001 – $180,000	$17,547 + 37% on amount over $80,000
$180,001 +	$54,547 + 45% on amount over $180,000 Plus TRBL (see below)

2.2 Temporary Budget Repair Levy (TBRL)

Date of effect: 1 July 2014 to 30 June 2017

The TBRL will apply at a rate of 2% on taxable incomes over $180,000 per annum. The measure is forecast to affect around 400,000 wage and salary earners and will bring the top marginal tax rate to 49% after taking into account the 2% Medicare levy.

The top marginal tax rate is also used as a reference for Fringe Benefits Tax (FBT), and therefore the rate will increase from 47% to 49% from 1 April 2015 until 31 March 2017, to align with the FBT year.

Profile's view: The attractiveness of salary sacrificing into superannuation will be greater for higher income earners due to the greater tax differential (now 49% versus 15%). The 'sweet spot' is for taxable incomes between $180,000 and $274,599 (the threshold for the higher contributions tax to super).

In light of the change to the FBT rate, the existing cash value of benefits received by Public Benevolent Institutions (PBI) and other recognised organisations will be protected. Therefore, the caps available will increase from $30,000 to $31,177 per employee for a PBI and $17,000 to $17,667 per employee for public hospitals and ambulance services.

Where there is flexibility, individuals may wish to consider deferring tax deductions until after 1 July 2014 or bringing forward income to before 30 June 2014 (such as any potentially realisable capital gains).

There are a number of areas where tax rates are currently set to equal the top marginal rate, and it is unclear at this stage whether these will also be subject to the levy:

- The taxation of unearned income for minors
- The tax rate applying to undistributed income of a trust
- The penalty tax rate applying to excess non-concessional superannuation contributions where a client does not elect to have these amounts refunded (as a result of the newly announced measure)
- Excessive employment termination payments
- Special income of a superannuation fund
- Excessive payments from untaxed superannuation funds

2.3 Medicare levy increase (previously announced)

Date of effect: 1 July 2014

The Medicare levy will rise to 2.0% (up from 1.5%). This was announced and legislated by the previous government, to assist with funding for the Disability Care Australia Fund (formerly known as the National Disability Insurance Scheme).

Profile's view: The Medicare Levy is not payable on death benefits paid to an estate. The increase is another reason to review your estate planning strategies, and perhaps consider structuring super payments to go to an estate rather than a non-dependent named beneficiary.

A reminder that generally, although tax rebates and offsets can reduce an individual's tax liability to zero, the Medicare levy can still be payable. It is possible to reduce the Medicare levy liability by including franking credits and the private health insurance offset.

2.4 Increase to the Medicare levy low-income thresholds for families

Date of effect: 1 July 2013

The low income threshold will increase for families from 2013/14. (The rates for singles and pensioners have already increased by more than the Consumer Price Index (CPI) increase and so no further increases are due now.)

	NO MEDICARE IF TAXABLE INCOME IS EQUAL TO OR LESS THAN:
Individuals	$20,542 (previously announced)
Single pensioners under age pension age	$32,279 (previously announced)
Couple (combined)	$34,367 (new)
Additional for each dependent child/student	$3,156 (new)

2.5 Changes to tax offsets

The following tax offsets are affected:

- Dependent Spouse Tax Offset (DSTO) to be abolished from 1 July 2014
- Mature Age Worker Tax Offset (MAWTO) to be abolished from 1 July 2014
- Dependent (Invalid and Carer) Tax Offset: income threshold to be reduced from $150,000 to $100,000 from 1 July 2015.

Profile's view: The intention is that mature age workers will be encouraged to participate in the workforce via direct payments and incentives. Prior recipients of the DSTO may be eligible for other tax offsets still in place.

2.6 Pausing indexation of the Medicare Levy Surcharge (MLS) and private health insurance thresholds

Date of effect: 1 July 2015

Individuals and families on incomes above the MLS threshold, who do not have a certain level of private health insurance, pay the MLS for any period during the year that they do not have that cover in place. The income thresholds will now not be indexed for three years, commencing 1 July 2015.

The current thresholds and rates are:

	STANDARD	TIER 1	TIER 2	TIER 3
Singles	$88,000 or less	$88,001 - $102,000	$102,001 - $136,000	$136,001 or more
Families	$176,000 or less	$176,001 - $204,000	$204,001 - $272,000	$272,001 or more
Medicare levy surcharge	0%	1.0%	1.25%	1.5%
Rebate payable on private health insurance premium:				
< Age 65	29.04%	19.36%	9.68%	0%
Age 65-69	33.88%	24.20%	14.52%	0%
Age 70+	38.72%	29.04%	19.36%	0%

Single parents and couples (including de facto couples) are subject to family tiers. For families with children, the thresholds are increased by $1,500 for each child after the first.

Profile's view: Those who have elected to not hold private health insurance will need to be diligent in assessing any impact of salary increases on the thresholds. The result could be a lower rebate or higher surcharge amount, or an increase in tax payable (via the levy).

2.7 Changes to the Higher Education Loan Programme (HELP)

Date of Effect: 1 July 2016

The government is proposing two major changes:

- A new indexation rate for outstanding debt, changing from CPI to the yield on Australian Government-issued 10 year bonds (capped at 6% pa).
- A 10% decrease to the income threshold at which minimum repayments must be made (it is currently $51,308).

Profile's view: The current level of indexation for outstanding loans effectively means no real increase in the level of debt. The proposed rate is still far more attractive than if the students accessed funds via a personal loan. Furthermore, the student only needs to start repaying the debt once their income is above $51,308 (2013/14). This amount is withheld by an employer, if the student has declared they have HELP liability on their Tax File Declaration form. Otherwise, the liability will fall due when lodging a tax return.

Consideration should also be given to the best use of any surplus capital that a student may have at their disposal. They should consider whether they may be better off retaining the HELP debt and repaying other debt such as a car loan or home loan first (based on prevailing yields of 10 year Australian Government bonds).

2.8 Reduction in company tax rate (previously announced)

Date of effect: 1 July 2015

The company tax rate will be reduced by 1.5% to 28.5%. However, companies earning more than $5M in taxable income will be liable for the 1.5% levy to fund the paid parental leave scheme, effectively offsetting the reduction.

Profile's view: The tax differential between individuals and companies for high income earners subject to the Temporary Budget Repair Levy (TBRL) is the greatest it has been since the 1980's. This could provide an opportunity for proprietors of small businesses operating through a company structure to retain earnings within their company structure until the TBRL expires on 30 June 2017.

2.9 Wage subsidy for mature age job seekers – Restart program

Date of effect: 1 July 2014

A payment of up to $10,000 will be made to employers who employ a worker aged 50 years or over who was previously receiving an income support payment (such as the DSP or NewStart). Payments will commence subject to the worker remaining employed for at least 6 months. Thereafter, the following instalments will be paid to the employer:

- $3,000 after six months of employment
- $3,000 after 12 months of employment
- $2,000 after 18 months of employment
- $2,000 after 24 months of employment

Profile's view: Employers are likely to continue to employ workers based on merit and ability, but will be conscious of the restart program incentives if a candidate has been out of work and is re-entering the workforce. There is no guidance on the nature of employment (part-time, casual), nor the hours worked to qualify for the instalments. No doubt, this will be made clearer in future legislation.

3 SUPERANNUATION

This budget was relatively light on changes to the Superannuation system.

3.1 Increased Super Guarantee Rate

Date of effect: 1 July 2014

The previously-announced Superannuation Guarantee increase to ultimately 12% will go ahead, however the timeline has changed:

FINANCIAL YEAR	% OF SALARY	CHANGE ON PREVIOUS YEAR
2013/14	9.25%	
2014/15	9.5%	↑0.25%
2015/16	9.5%	
2016/17	9.5%	
2017/18	9.5%	
2018/19	10%	↑0.5%
2019/20	10.5%	↑0.5%
2020/21	11%	↑0.5%
2021/22	11.5%	↑0.5%
2022/23	12%	↑0.5%

Profile's view: The overall increase to 12% for employees is still on track, albeit a year later than previously announced. Clients with existing salary sacrifice arrangements will need to be aware of the increased SG amount, to ensure they are not breaching concessional contribution caps.

3.2 Excess non-concessional contributions

Date of effect: non-concessional contributions made from 1 July 2013

People who have made non-concessional super contributions from 1 July 2013 which exceed the cap will have the option to withdraw the excess amount plus earnings on the excess.

Previously, if you exceeded your non-concessional contribution cap, a tax penalty applied at the rate of 46.5%. This meant that for people not on the top marginal tax rate, the resulting tax paid would be greater than if they had just received it as salary (even if it was by accident or not their fault).

All excess non-concessional contributions (made after 1 July 2013) will now be able to be refunded and associated earnings with the penalty rate of tax being applied at your marginal tax rate. However for those who do not withdraw the excess contribution, they will continue to incur the penalty tax of 46.5% (whether the extra 2% debt level will also apply is unclear at this stage).

Profile's view: This is a fair change to the previously unfair non-concessional excess contributions tax. While there are some questions to be answered on the implementation of this – for example, how the earnings are calculated, will the accounts have to be rolled back to super if a pension has since commenced, and so on - the government has pledged to work with the super industry to find a process that works.

3.3 Indexation of super contribution caps (previously announced)

Date of effect: 1 July 2014

While not a budget change, it's worth noting that the caps on contributions to super are being indexed from 1 July 2014:

- Concessional contributions: These caps are being indexed to $30,000 for the 2014/15 financial year if you are under 49, or $35,000 if you are 49 years or over, on 30 June 2014
- Non-concessional contributions: this cap is being indexed from its current $150,000 to $180,000 from 1 July 2014.

3.4 Defence Forces Retirement Benefits (DFRB) and Defence Force Retirement and Death Benefits (DFRDB)

Date of effect: 1 July 2014

Since January 2002, DFRDB pensioner payments have been adjusted for movements in the Consumer Price Index (CPI) twice yearly. Adjustments occur on the first pension payday of January and July. From 1 July 2014, DFRB and DFRDB superannuation scheme members aged 55 and over will have their superannuation benefits indexed by the better of the Consumer Price Index and the Pensioner and Beneficiary Living Cost Index, with reference also to a benchmark level of Male Total Average Weekly Earnings.

Furthermore, the government will allow ADF members to choose which superannuation fund they belong to and, for the first time, give those members the right to transfer the accumulated portion of their super fund to a new fund if they leave the ADF.

Profile's view: This is a great benefit for defence force retirees, and over time will appreciably increase the real value of their incomes. For example, in the most recent quarter (Jan-Mar 2014), the Pensioner and Beneficiary Living Cost Index rose by 1.1% whereas the Consumer Price Index only rose by 0.6%.

3.5 Cessation of First Home Saver Accounts

Date of effect: 1 July 2014

Aimed at assisting people to buy their first home, First Home Saver Accounts (which started in 2008) provided a 17% government co-contribution on the first $6,000 contributed into the account each year.

From budget night, no new First Home Saver Accounts will be accepted. In addition, for existing accounts:

- the co-contribution will cease from 1 July 2014,
- tax concessions, income and asset test exemptions for government benefits will cease from 1 July 2015, and
- from 1 July 2015, account holders will be able to withdraw their account balances without restriction.

Profile's view: This is disappointing for those who are actively saving for their first home and the accounts were popular, with approximately 46,000 opened since the start of the scheme. However the withdrawal of concessional treatment has at least been balanced by the opening up of access to the accounts so holders can now access their funds for any purpose.

4 SOCIAL SECURITY

While there have been a number of changes to unemployment, youth and disability payments announced in this year's budget we have focused our analysis on the changes that are most likely to impact senior Australians.

4.1 Commonwealth Senior Health Care Card (CSHC)

Date of effect: 1 July 2014: CSHC holders will cease to receive the quarterly Seniors Supplement payment (currently $165.10 per quarter for each member of a couple, or $219.05 per quarter for singles or couples separated by illness).

Date of effect: September 2014: To be eligible for a CSHC, a person must currently have an adjusted taxable income of under:

- $50,000 (singles)
- $80,000 (couples, combined)
- $100,000 (Couples, combined, separated by illness or respite care)

From September 2014 these income thresholds will start being indexed to the CPI.

Date of effect: 1 January 2015 (with grandfathering for existing arrangements): Deemed income from Account Based Pensions commenced after 1 January 2015 will be included in the income test

Profile's view: These changes have a number of implications for senior Australians. Firstly, it provides an incentive to commence an Account Based Pension with your superannuation benefits prior to 1 Jan 2015. However, due to the "grandfathering" provision it appears to have the unintended consequence of effectively "locking in" clients to their existing pension providers, as changing providers would see the new deeming rules applied to them.

As an example, assuming current deeming rates and thresholds, and no other assessable income, a couple that commenced their Account Based Pensions after 1 January 2015 will not qualify for a CSHC when their combined account balances exceed $2,318,886 ($1,448,543 for singles).

These changes will also affect people with lower Account Based Pension balances where they have other Adjusted Taxable Income from other sources such as employment, personally held investments, foreign pensions or untaxed government pension schemes.

4.2 Age pension – increase in eligibility age

Anyone currently aged 48 or younger will now need to wait until age 70 before becoming eligible for the age pension. This increase is to be phased in over a number years following the completion of the previously announced phased in increase from 65 to 67:

DATE OF BIRTH BETWEEN	AGE AT WHICH ELIGIBLE FOR THE AGE PENSION
1 July 1952 and 31 December 1953	65½
1 January 1954 and 30 June 1955	66
1 July 1955 and 31 December 1956	66½
1 January 1957 and 30 June 1958	67
1 July 1958 and 31 December 1959	67½
1 January 1960 and 30 June 1961	68
1 July 1961 and 31 December 1962	68½
1 January 1963 and 30 June 1964	69
1 July 1964 and 31 December 1965	69½
1 January 1966 and later	70

Profile's view: On the good side, those affected have over 20 years to plan for this change. As an example, suppose a couple who were both planning to stop working at 65 originally expected to receive a partial age pension of $15,000 (combined). To replace this $15,000 pa for 5 years, you would need to save an extra approximately $45 per week (increasing each year with inflation) for 20 years (assuming an after-tax investment return of 6.6% pa and inflation of 3%pa).

4.3 Deeming rate thresholds for income test reduced

Date of effect: 1 September 2017

The deeming rate thresholds are to be reduced from $46,600 to $30,000 for single pensioners and from $77,400 to $50,000 for pensioner couples.

Profile's view: While the majority of clients receiving age pension benefits are affected by the assets test rather than the income test, for those who are income tested the effects are quite significant. As an example, if you are a single pensioner who is income tested, with over $46,600 of deemed financial assets, then your fortnightly payment could fall by $290.50.

4.4 Income and asset test-free area thresholds frozen for various government payments

Date of effect: 1 July 2014

Family Tax Benefit, Child Care Benefit, Child Care Rebate, Newstart Allowance, Parenting Payments and Youth Allowance income and asset test-free thresholds will be frozen (ie, no indexation to apply) for the following 3 years.

Date of effect: 1 July 2017

Age Pension, Carer Payment, Disability Support Pension and the Veterans' Service Pension income and asset test-free thresholds will be frozen (ie, no indexation to apply) for the following 3 years.

4.5 Indexation of pension and other payments to be linked to the consumer price index (CPI)

Date of effect: 1 July 2014 for Single parenting Payment recipients, **1 September 2017** for age pension, disability support pension, veterans' affairs pension, carer payment and bereavement allowance.

The current system of indexation applies an increase based on the higher of the change in CPI or male total average weekly earnings or the pensioner and beneficiary living cost index.

Profile's view: Looking through the historical records from the Australian Bureau of Statics, this change is likely to result in lower indexation rates to apply to these payments in most periods in the future.

4.6 Cancellation of home down-sizing trial for seniors

Date of effect: Immediate

In last year's budget the Government announced a 3 year 'home downsizing' trial that would have commenced from 1 July 2014. This would have allowed people of age pension age who had owned their home for at least 25 years and downsized their home, to receive significant asset and income test concessions on the surplus sale proceeds. The Government will now not proceed with the trial.

4.7 Changes to concessions for Pensioners and Seniors card

Date of effect: 1 July 2014

The government will terminate the National Partnership Agreement on certain concessions for pensioner concession and seniors card holders. This agreement currently contributes funding to State, Territory and local government provision of certain concessions.

Profile's view: It is unclear at this stage which concessions may be removed or reduced. Some of the current concessions that could be at risk include discounted council rates, utilities and public transport fares.