DEWINGS
ACCOUNTING + CONSULTING

Welcome to our latest e-newsletter.

It's a new financial year, and with that we take a deeper dive into the superannuation changes that were announced in the most recent Federal Budget and look at why, collectively, they are bad for all superannuation members, not just the wealthy. Plus we remind you that the company tax rate for small businesses (which will include a lot more companies now) has been reduced from 1st July.

In this edition...

The not-so-Super Federal Budget

There's been a lot of publicity since Budget night around the Turnbull Government's proposed changes to superannuation. In particular, much of the discussion has centred around who is likely to be most affected. After all, if it really does only impact the most wealthy of Australians, isn't that a reasonable compromise to see us through difficult economic times? But the problem with this Budget's multi-fronted attack on superannuation is not the specific nature of the changes. Its sweeping scope, and in some cases immediate and even retrospective application, goes well beyond the incremental ratcheting of superannuation uncertainty we've come to expect each year around Budget time. It's a wrecking ball to confidence in superannuation and threatens the retirement plans of many Australians.

It's fair to say we've been living in a Golden Age for superannuation over the last decade or so. When many of the changes that we now take for granted in super were announced by the Howard Government in 2006, including making superannuation savings completely tax free in retirement, it seemed too good to be true, and we always suspected that it couldn't last forever. So to some extent we've advised our clients to make hay while the sun shines. Recent rumblings from Canberra only enhanced the suspicion that the good times might be coming to an end.

A reasonable person would concede that with a large budget deficit and fundamental structural uncertainty in the Australian economy, some winding back of these generous concessions may now be in order. Last year Labor announced that it would tax post-retirement earnings in superannuation that exceeded $75,000 per year. Currently, when a person retires (or starts taking a transition to retirement pension - see below), earnings in super become tax free. Labor estimated that it would require a balance of about $1.5 million in super to make enough to exceed this limit. This was effectively matched by the Coalition in this year's Budget when they announced that post-retirement earnings on that portion of a member's balance exceeding $1.6 million would be taxed.

While we never like the idea of paying more tax, and we're not sure that a single threshold for all taxpayers is necessarily fair, some form of this announcement was not entirely unexpected. In some ways it's a return to the previous practice of limiting how much a person could put into super. For a couple, this measure still allows them to have a balance of $3.2 million without being taxed in retirement, and even the excess will still only be taxed at the concessional rate of 15%. Again, it's more tinkering, which is never ideal for retirement planning, but it's not a complete surprise.

It's the fact that this is only one component of a multi-faceted assault that has us shaking our heads, and it's not only the rich who will be affected.

Take for example the announcement that concessional contributions will be capped at $25,000 per annum from 1st July 2017. Currently, you can put away up to $30,000 a year if you're under 49 years of age, and $35,000 if you're over.

These limits were reduced to $25,000 in the 2012-13 Federal Budget as well, as a temporary repair measure. They have been increased a couple of times since then in recognition that there are many cases where $25,000 a year would not provide enough for a person to retire on. For example, let's say a person has a business where they manage a decent living without achieving anything extravagant. For years they sacrifice to provide for their family, pay off their mortgage and get their kids through school. Inevitably, the kids grow up and begin their own lives of self-sufficiency. Maybe the last child moves out when the parents are in their early fifties. Now they finally have some surplus income and need to start catching up on their super if they're going to have enough to retire on in a few years time. The current additional concessional contribution limit for people over 49 is intended for exactly this purpose. Four years ago the Government recognised that $25,000 per annum would not be sufficient for such people to accumulate enough to retire on, which is why the reduction at that time was a temporary measure, with a road-map to increase the limits again in following years. This Budget has now set these limits at $25,000 for everyone, indefinitely.

The ability to catch up for years when you haven’t made $25,000 in contributions has been introduced, but its application is limited. We address this in a separate article below.

Another measure that will impact ordinary Australians is the proposed change to 'transition to retirement' earnings. Currently, when a person reaches 60 years of age, they can start taking a pension from super and still keep working. The pension will be tax free, and at this point all the earnings in the fund also become tax free (technically a pension can be commenced earlier than this but the pension itself will not be tax free until the person turns 60). From 1st July 2017, the pension will continue to be tax free, but the earnings in the fund will be taxed at 15% until the person retires.

A transition to retirement pension is an opportunity available to anyone, regardless of how much they have in super and what they have earned over their working life. Keep in mind that balances under $1.6 million will continue to be tax free when the person finally does retire completely, so all that is happening under the current rules is that when a person becomes eligible to retire but wants to keep working, the benefit is brought forward a few years to encourage them to stay in the workforce. Given that the Government has made much of the need for Australians to work for longer, this unforeseen measure seems a strange contradiction to that message. The additional tax will reduce the ability of some to support themselves in retirement, and potentially provides an encouragement for others to retire earlier rather than pay additional tax.

Perhaps the most aggressive measure is the change to the non-concessional contributions limits. 'Non-concessional' contributions are those that come from after-tax income. Effectively, it's a way of moving money from outside of super into your fund, where it is safer and attracts a lower rate of tax. Previously, a person may contribute up to $180,000 a year into super this way and pay no tax, or up to $540,000 in any three year period. The Government announced on Budget night that these limits would be reduced to a maximum of $500,000 over the lifetime of the member.

These limits have been very generous for a long time, and we have previously speculated that at some point they may be pared back. The problem here is the manner in which it has happened, and the fact that it has been announced in conjunction with a raft of other changes. Unlike those other changes, this $500,000 limit applies from May 3rd 2016 (Budget night) and takes into account any contributions made since 2007! In other words, if your non-concessional contributions have exceeded $500,000 in total since 1st July 2007, this opportunity is now closed to you forever.

This is where the uncertainty created by these measures really starts to be felt. This is not a concession reserved exclusively for the elite. For example, it is often used by those in business to buy commercial premises for a business to operate from. Imagine if a contract was signed for a property in the name of a super fund on May 1st, and that contract was relying on non-concessional contributions from the member to pay the deposit? If the deposit exceeded that limit (quite possible, because borrowing in super requires a much higher minimum deposit) or if previous non-concessional contributions had been made after 2007, how would the contract be fulfilled? There are numerous other scenarios where a person may have been caught mid-strategy, with a completely different landscape appearing overnight that not only changes their plans, but may in fact result in adverse consequences.

Worse, even though it has been announced, the measure is not yet legislated, so we sit in limbo waiting to see what will happen - with a retrospective date of effect, the uncertainty of the weekend's election result casting a huge shadow and the knowledge that getting anything through the Senate is likely to be difficult - unable to do anything in case it becomes law at a later point in time.

Together with a reduction in the Superannuation Surcharge income threshold from $300,000 to $250,000 (which was also foreshadowed by Labor), these changes are more than a measured winding back of the generous super concessions we have enjoyed over the last 10 years. They are an unprecedented attack on retirement savings, with little industry consultation, and are a destabilising threat to a sector that needs certainty for critical forward planning.

We're not playing partisan politics here. We expect that Labor is likely to keep many of these measures if they get the opportunity to form Government. Resisting change in opposition is much easier than balancing a Budget when in power, and the low-hanging fruit of implementing these changes 'reluctantly' while blaming the previous Government (we think) would be far too tempting to resist. The only hope now is a groundswell of opposition from the electorate.

We accept that the last 10 years have created some fantastic opportunities for saving tax and creating wealth. We acknowledge that when the fiscal outlook is bleak there may be a case for moderating generous tax concessions that, it could be argued, disproportionately benefit those with greater wealth. But let's also bear in mind that certainty in superannuation is critical for retirement planning. For far too long superannuation has been easy pickings for successive Governments looking for a quick Budget fix, and this Budget has taken that approach to the extreme - without using the savings to actually fix the Budget. Rather than working with the industry to identify distortion in the system and develop a graduated timeline for reasonable reform, the Government has dropped a bomb on superannuation that will result in a far wider scope of damage than the projected 'top 4 per cent' of superannuation account holders.

If superannuation must be reshaped into something more modest and sustainable, this Budget is a sledgehammer where pruning shears are required. It remains to be seen how much of it will actually pass into legislation, but for all except the non-concessional contributions changes, there remains another year before implementation, which means opportunities still exist and early planning is more important than ever. If you would like to review your circumstances please contact us.

Concessional contributions 'catch-up' - the Budget silver lining

The Federal Budget wasn't all doom and gloom for superannuation. One positive announcement was the concessional contributions 'catch-up'.

Right now, if you're 49 years of age or under you can put away up to $30,000 in superannuation contributions and only pay 15% tax on them (provided you earn less than $300,000 per year). If you're older than that, you can contribute up to $35,000 per year. These limits will be dropping to $25,000 per annum for everyone from 1st July 2017, which may adversely impact the ability of some workers to save enough for retirement.

One factor that can further limit a person's superannuation savings is a disruption to their work. A long term illness, parental leave or becoming a full-time carer are just some of the life changes that may require a person to take a significant amount of time off work. If that person had also been making superannuation contributions up to their maximum limit each year, it's likely that these too would be reduced while they are away from work.

Under current law, when a person returns to work from a longer term break, they are still only eligible, in subsequent

A company tax rate gift from 1st July

A reminder to those of you who operate your business through a company - this year's Federal Budget also announced that the company tax rate for small businesses will drop from 28.5% to 27.5% from 1st July 2016.

The news came with a sizeable cherry on top too. The turnover threshold at which a business is considered 'small' will be lifted from $2 million to $10 million from 1st July. This means the reduction in the company tax rate will apply to a significant number of additional business owners.

It's worth noting though that if you're in the habit of taking all of your profit out of the company for personal purposes, there is no net tax saving with a change in company tax rates. Whatever you save in the company will be made up in personal tax, since you pay the difference between the imputation credit from the company (a credit for the tax already paid) and your own personal marginal rate of tax.

But if you can manage it, the tax saving represents a great opportunity to reinvest a little into your business. The saving may only be small, but every little bit helps.

The proposed change to the small business eligibility threshold also means years, for the same contributions caps as everyone else. But from 1st July 2017, individuals will be allowed to use up previous years' cap shortfalls to make up what they have missed.

It's like a data rollover plan on your phone. If you only contributed $15,000 last year, you'll be able to contribute $35,000 the following year (the $25,000 cap plus an extra $10,000 from the previous year), and this will apply for up to five years' worth of shortfalls.

There is one condition to this, which is that it will only apply for people whose balance in super is less than $500,000. This aspect of the provision is a little disappointing, since it may rule out a lot of older Australians, but the argument goes that if you have more than $500,000 in super, you may be less likely to need assistance. This measure is really targeted at those struggling to accumulate enough for retirement, who have their savings further disrupted by a significant life event.

Once again, there is no certainty at the moment as to whether this proposal will actually become law, but it's a great idea that will be welcome news for many.

that any business that earns less than $10 million a year, regardless of whether it is a company or not, can access a range of other small business concessions. For example, a business that previously turned over more than $2 million per annum but less than $10 million may also now be eligible for the $20,000 instant asset write-off concession, which allows you to claim the full amount of some equipment purchases in the first year, instead of having to depreciate it over a number of years. If this is you and you've been considering an equipment purchase, it may be worth doing it now and getting the cash flow benefit of an immediate tax deduction (provided it costs less than $20,000, and perhaps subject to the final outcome of the election).

Other concessions you can access when classified as a 'small' business include more simplified depreciation and trading stock rules, and immediate deductions for prepaid expenses.

If you think you may be affected and would like some further advice, please contact us.

It's worth noting at this point that while these changes have been announced, nothing has been legislated yet. So you should bear in mind that some or all of it is subject to change, and is particularly dependent on the final election result. Labor previously indicated that they will support the tax rate change but not the lift in the small business turnover threshold.