Self Managed Super Fund Association

SMSF Association Budget Update 2016-17: The most significant changes to superannuation since 2007

Last night, the Government delivered the 2016-17 Federal Budget, its last before a looming double dissolution election. Superannuation was a key focus of the Budget with the Government's superannuation package being the most significant changes to superannuation since Peter Costello's Simpler Super package was announced in the 2006-07 Budget, netting it approximately $2.9 billion over the forward estimate period. Substantial changes were made to contributions, transition to retirement and the retirement phase.

Going forward, the Government is predicting a Budget deficit of $37.1 billion in 2016-17 (2.2% of GDP) with no surplus predicted in the Government's medium term projections but with the Budget deficit reduced to $6.0 billion by 2019-20. As with other recent Budgets, the improvement in the Government's bottom line has a greater reliance on tax revenues recovering (predicated on a return to 3% per annum GDP) growth rather than spending restraint.

In addition to the super changes, the Government has delivered a cautious pre-election Budget with targeted tax relief for middle income earners and businesses. Middle income earners will receive tax relief as the Government will increase the 32.5 per cent personal income tax threshold from $80,000 to $87,000 from 1 July 2016. The business tax package will see the corporate tax rate dropped to 25% over a 10-year period, reducing the small business tax rate to 27.5% from 1 July 2016, increase the turnover test for small businesses to access tax concessions to $10 million per annum (notably not applying to CGT concessions though), and increase the tax discount for unincorporated small businesses incrementally over 10 years from 5 per cent to 16 per cent, shifting to 8% on 1 July 2016. Also, businesses and young job seekers will benefit from an $840 million raft of incentives for business to offer young people internships and employment as well as job readiness training.

Other notable revenue measures include a raise in tobacco excise to net $4.7 billion over the forward estimate period, the inception of a Tax Avoidance Taskforce which will undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals an expected to benefit to revenue of $3.7 billion. The Budget also contained spending boost for schools and hospitals and an ongoing $50 billion infrastructure spend commitment.

The Government's superannuation package offers a mixed bag for SMSFs with significant (and somewhat complex) changes targeting higher income earners and high balance superannuation accounts while significant red-tape improvements have been made to the super system. The key measures are:

- A reduction in concessional contribution caps for all taxpayers to $25,000.
- Lowering the Division 293 tax threshold to $250,000.
- A $500,000 lifetime limit for non-concessional contributions
- A $1.6 million limit on assets in retirement phase that will have tax-free earnings.
- Allowing carry-forward of unused concessional caps over a 5 year period for people with balances under $500,000.
- Removing the tax-exempt treatment of assets that support Transition to retirement income streams.

- Removing the 10% rule for deductible superannuation contributions.
- Introducing a Low Income Superannuation Tax Offset (LISTO) to replace the Low Income Superannuation Contribution.
- Removing the work test for contributions made between 65 and 75.

Overall, the Government's changes bring it close to $6 billion from superannuation with just over $3 billion being given back to super through measures that cost the Government revenue such as the LISTO, abolishing the 10% rule and allowing limited carry-forward of concessional contribution caps.

The proposed changes, which will need to be legislated after the upcoming election, represent a substantial reshaping of the superannuation system while only affecting a small subset of superannuation fund members – those with high balances and those that make voluntary contributions to superannuation. With the majority of the measures being targeted from a 1 July 2017 start date this will present a major challenge for the industry to be ready for the changes and for SMSF members to adjust their retirement savings strategies.

Superannuation measures

1. Lowering the concessional contribution cap to $25,000 for all individuals.

From 1 July 2017, the Government proposes to lower the concessional contribution cap to $25,000 for **all taxpayers**. The cap will be indexed in line with wages growth.

The existing contribution caps (30,000 for these aged under 50, and $35,000 for those aged above 50) will be retained for 2016-17.

SMSF Association view

We are greatly disappointed the Government has chosen to reduce the concessional contribution cap, especially in addition to the other measures that reduce the concessional treatment of superannuation. We strongly believe that adequate concessional contribution caps are required to allow people to save an adequate amount for retirement. It is especially important that people approaching retirement have adequate contribution caps to maximise contributions to superannuation when they are more likely to have the financial resources to do so. While this may be ameliorated somewhat by the carry forward of unused concessional contributions, the $500,000 balance limit on this measure (see below) restricts people building truly adequate retirement incomes.

2. Lowering the threshold of Division 293 tax

The Government is proposing lowering the Division 293 tax threshold from $300,000 to $250,000 from 1 July 2017.

This measure and the reduction of the concessional contribution cap will have a gain to revenue of $2.5 billion over the forward estimates period.

SMSF Association view

In the current fiscal environment, it is expected that the sustainability of superannuation would be an issue for Government to address, and that higher income earners' concessional contributions wold be targeted. We are pleased that these changes have been limited to the $250,000 threshold instead of $180,000 as rumoured. However, we are disappointed that the concessional contribution caps have been cut in addition to this measure.

Self Managed Super Fund Association

Additionally, we estimate that this measure will double the number of taxpayers caught by Division 293 tax and accordingly believe that the existing complex and clunky Division 293 tax collection arrangements need to be improved.

3. Introducing a lifetime cap for non-concessional contributions

From 7.30pm (AEST) last night (3 May 2016) the Government is proposing to introduce a $500,000 lifetime cap on non-concessional contributions (NCCs). The lifetime cap will take into account NCCs made since 1 July 2007. The cap will be indexed in $50,000 amounts in line with wages.

Individuals that have made $500,000 of NCCs will be taken to have used their lifetime cap and will not be able to make further NCCs. NCCs in excess of the new lifetime limit will have to be withdrawn or face a penalty tax, similar to the current treatment of excess NCCs.

The lifetime NCC limit will remove the existing $180,000 annual cap and the bring forward rule. This will increase the amount of annual NCCs people aged 65 and over can make if they have net used their lifetime cap.

This measure will have a gain to revenue of $550 million over the forward estimates period.

SMSF Association view

While we recognise that the existing NCC regime can allow wealthy taxpayers to accrue significant balances inside superannuation we do not believe that this measure is an appropriate way of ensuring the fairness and sustainability of the superannuation system. While a $500,000 limit is generous enough to meet most taxpayer's needs, we are concerned about the complexity of a lifetime cap and the fact that the new limit applies to NCCs made since 1 July 2007. This seems to introduce an element of retrospectivity and unfairness for people who made NCCs under the existing rules.

4. Introducing a $1.6 million superannuation transfer balance cap

From 1 July 2017, the Government proposes to introduce a $1.6 million limit on individuals' superannuation balances that can be "transferred" from accumulation phase to retirement phase. Subsequent earnings on retirement balances will not be restricted. Individuals that have amounts in excess of $1.6 million will be able to maintain those amounts in accumulation phase where earnings will be taxed under the current 15% treatment.

Superannuation fund members already in the retirement phase that have balances in excess of $1.6 million will be required to reduce their retirement balances to $1.6 million by 1 July 2017. They will either be able to retain excess amounts in accumulation phase or withdraw them from superannuation.

Amounts transferred in excess of $1.6 million to retirement will be taxed in a similar way to excess non-concessional contributions. That means both the excess amount and earnings on that excess amount in retirement phase will be taxed.

The $1.6 million cap will be indexed in $100,000 increments in line with the consumer price index. Where a member has previously used up a proportion of their retirement balance limit, they will be able to us the remaining proportion of the indexed cap.

This measure effectively limits the benefits of tax-free earnings on assets supporting retirement. The Government believes that this measure is necessary to make the superannuation system more fiscally sustainable, noting that it will limit attractiveness of superannuation for tax minimisation and estate planning purposes.

This measure will have a gain to Government revenue of $2.0 billion over the forward estimates.

SMSF Association view:

This measure is clearly targeted at ensuring superannuation is not an open ended tax-free retirement savings vehicle, something that was pre-empted by Treasurer, Scott Morrison in the lead-up to the Budget. While the $1.6 million amount is reasonable (e.g. assuming a $1.6 million balance earning 5% per annum achieves income of $80,000 per annum without drawing down on capital) and is unlikely to affect most trustees, we are concerned by the complexity that the measure creates for the superannuation system.

Also, we believe that members are likely to remove excess amounts above the $1.6 million limit out of superannuation and seek other tax effective arrangements including using the Low Income Tax Offset and Seniors and Pensioners Tax Offset to minimise tax on earnings outside of super. Ultimately, while it may be reasonable to limit the tax benefits of supination to ensure the system is sustainable, we believe it can be done in a more efficient and simple manner.

5. Allowing catch-up concessional contributions

From 1 July 2017, the Government proposes to allow people with superannuation balances under $500,000 to carry forward unused concessional cap space on a rolling 5-year basis. The Government is introducing this measure to improve flexibility of the concessional contribution regime, making saving for retirement easier for people with broken work patterns

This measure will have a cost to revenue of $350 million over the forward estimates period.

SMSF Association view

While this measure is a positive step to making contributions to super more flexible, which is something the SMSF Association advocated for in our Pre-Budget submission we are disappointed that the Government is proposing to limit the rule to people with superannuation balances below $500,000. We do not believe that a $500,000 superannuation balance is an adequate superannuation balance for retirement, especially when considering the financial risks in retirement created by health, aging and longevity. For example, a $500,000 balance with earnings of 5% per annum will generate income of $25,000 per annum (without capital drawdown) - an amount that we would not support as adequate to sustain a dignified and secure retirement.

6. Tax deductions for personal superannuation contributions

From 1 July 2017, the Government will allow all Australians aged under 75 to claim an income tax deduction for personal contributions made to superannuation funds. This effectively removes the "10% rule", allowing all members to make personal deductible contributions to super.

This measure will have a cost to revenue of $1.0 billion over the forward estimates period.

SMSF Association view

We are very pleased that the Government has chosen to abolish the "10% rule" which we have been advocating for in our recent Pre-Budget submissions. This will reduce significant red-tape and complexity from the superannuation system and benefit employers, especially small businesses. The significant revenue cost of doing this - $1 billion over the forward estimates – is illustrative of the trade-offs the superannuation system is subject to in the 2016 Budget.

7. Introducing a Low Income Superannuation Tax Offset (LISTO)

From 1 July 2017, the Government proposes to introduce the Low Income Superannuation Tax Offset (LISTO) which will replace the existing Low Income Superannuation Contribution (LISC). A non-refundable tax offset will be provided to superannuation funds based on the tax paid on concessional contributions by people with adjusted taxable income up to $37,000.

This measure will have a cost to revenue of $1.6 billion over the forward estimates period.

SMSF Association view

We are pleased that the Government is going to restore the LISC treatment for low income earners as this makes the superannuation system more equitable. This is a change we have been arguing for since the LISC was abolished from 1 July 2017 in the 2014 Budget.

8. Removing the tax-free treatment of assets supporting transition to retirement income streams

From 1 July 2017, the Government proposes to remove the tax exempt status of assets supporting transition to retirement income streams (TRIS). Instead these assets will be taxed at the 15% rate. This new tax treatment will **apply to all** TRIS, irrespective of when they were commenced. Additionally, taxpayers will no longer be able to elect to treat TRIS payments as lump sums for tax purposes, which makes them tax-free under the low rate cap.

This measure will have a gain to revenue of $640 million over the forward estimates period.

SMSF Association view

Changes to the TRIS rules had been telegraphed by the Government, so these changes are not surprising and more positive than other possible changes such as banning TRIS all together. However, we would expect the changes to make TRIS far less attractive to super fund members.

9. Harmonising contribution rules for those aged 65 to 74

From 1 July 2017, the Government proposes to improve the ability of older Australians to contribute to superannuation by:

- Removing the requirement that a person aged from 65 to 74 meets a work test before making concessional or non-concessional contributions to superannuation, and
- Allow people to make contributions to a spouse aged under 75 without the need for the spouse to meet the work test.

This measure will have a cost to revenue of $130 million over the forward estimates period.

SMSF Association view

We strongly endorse these changes and believe that the removal of the work test for people aged 65 to 74 will result in significant compliance savings for SMSF members. The SMSF Association had long been arguing for simplification of contributions for people aged 65 and over.

10. Legislating the objective of super

The Government will be legislating the objective of superannuation as ‘to provide income in retirement to substitute or supplement the Age Pension’ which was the objective recommended by the Financial System Inquiry.

SMSF Association view
We support the enshrinement of objectives for supernational in legislation but believe that this should have been done in advance of significant superannuation tax changes.

11. Remove the anti-detriment provision
From 1 July 2017, the Government proposes to remove the anti-detriment provision on the basis that it is outdated and applies unevenly to superannuation funds.

This measure will have a gain to revenue of $350 million over the forward estimates period.

SMSF Association view
We believe that this is an appropriate amendment to make the supernational system sustainable.

12. Enhancing choice in retirement products
From 1 July 2017, the Government proposes to extend the tax-exemption on earnings in the retirement phase to retirement products such as deferred lifetime annuities and group self-annuitisation products.

The Government advises that this will have no Budget impact.

SMSF Association view
We support these changes as long as all retirement income products, including account based pensions, have an even playing field.

13. Improve superannuation balances of low income spouses
From 1 July 2017, the Government proposes to extend the eligibility rules for the low income spouse superannuation tax offset by raising the threshold for a low income spouse to $37,000 up from $10,800.

This measure will have a cost to revenue of $10 million over the forward estimates period.

SMSF Association view
This is a positive change which can assist in topping up super contributions for people with broken work patterns.

Other measures of interest for SMSF Association members

14. Targeted personal income tax relief
The Government will increase the 32.5 per cent personal income tax threshold from $80,000 to $87,000 from 1 July 2016. This measure will reduce the marginal rate of tax on incomes between $80,000 and $87,000 from 37 per cent to 32.5 per cent, preventing around 500,000 taxpayers facing the 37 per cent marginal tax rate. This will ensure that the average full-time wage earner will not move into the second highest tax bracket in the next three years. In the absence of this action, they would move into the second highest tax bracket in 2016-17.

This measure has a cost to revenue of $4.0 billion over the forward estimates period.

15. 10 year plan to reduce the company tax rate to 25%
The Government will reduce the company tax rate to 25 per cent over 10 years. The tax rate for businesses with an annual aggregated turnover of less than $10.0 million will be 27.5 per cent from the 2016-17 income year. The threshold will then be progressively increased to ultimately have all

companies at 27.5 per cent in the 2023-24 income year. The annual aggregated turnover thresholds for companies facing a tax rate of 27.5 per cent will be:

- $25.0 million in the 2017-18 income year,
- $50.0 million in the 2018-19 income year,
- $100.0 million in the 2019-20 income year,
- $250.0 million in the 2020-21 income year,
- $500.0 million in the 2021-22 income year, and
- $1 billion in the 2022-23 income year.

In the 2024-25 income year the company tax rate will be reduced to 27 per cent and then be reduced progressively by 1 percentage point per year until it reaches 25 per cent in the 2026-27 income year. Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

This measure is expected to have a cost to revenue of $2.7 billion over the forward estimates period.

16. Increasing small business entity turnover

The Government will increase the small business entity turnover threshold from $2.0 million to $10.0 million from 1 July 2016. The current $2.0 million turnover threshold will be retained for access to the small business capital gains tax concessions, and access to the unincorporated small business tax discount will be limited to entities with turnover less than $5.0 million. An additional 90,000 to 100,000 business entities will gain access to the small business concessions, such as the lower small business corporate tax rate, accelerated depreciation and depreciation pooling provisions.

This measure is estimated to have a cost of $2.2 billion over the forward estimates period.

17. Increase the unincorporated small business tax discount

The Government will increase the tax discount for unincorporated small businesses incrementally over 10 years from 5 per cent to 16 per cent. The tax discount will increase to 8 per cent on 1 July 2016, remain constant at 8 per cent for eight years, then increase to 10 per cent in 2024-25, 13 per cent in 2025-26 and reach a new permanent discount of 16 per cent in 2026-27. This will coincide with staggered cuts in the corporate tax rate to 25 per cent. The current cap of $1,000 per individual for each income year will be retained.

The tax discount applies to the income tax payable on the business income received from an unincorporated small business entity. Access to the discount will be extended to individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than $5.0 million.

This measure is estimated to have a cost to revenue of $450.0 million over the forward estimates period.

18. Targeted amendments to Division 7A

The Government will make targeted amendments to improve the operation and administration of Division 7A of the *Income Tax Assessment Act 1936* (an integrity rule for closely held groups).

These changes will provide clearer rules for taxpayers and assist in easing their compliance burden while maintaining the overall integrity and policy intent of Division 7A. It includes a self-correction mechanism for inadvertent breaches of Division 7A, appropriate safe-harbour rules to provide certainty, simplified Division 7A loan arrangements and a number of technical adjustments to improve the operation of Division 7A and provide increased certainty for taxpayers.

This measure is estimated to have an unquantifiable cost to revenue over the forward estimates period.

19. Tax integrity package

The Government will provide $678.9 million to the Australian Taxation Office (ATO) over the forward estimates period to establish a new Tax Avoidance Taskforce. This will enable the ATO to undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals.

This measure is estimated to have a gain to revenue of $3.7 billion over the forward estimates period.

20. Personal Income Tax — increasing the Medicare levy low-income thresholds

The Government will increase the Medicare levy low-income thresholds for singles, families and seniors and pensioners from the 2015-16 income year. The increases take account of movements in the Consumer Price Index so that low income taxpayers generally continue to be exempted from paying the Medicare levy.

The threshold for singles will be increased to $21,335. For couples with no children, the threshold will be increased to $36,001 and the additional amount of threshold for each dependent child or student will be increased to $3,306. For single seniors and pensioners, the threshold will be increased to $33,738. For senior and pensioner couples with no children, the threshold will be increased to $46,966 and the additional amount of threshold for each dependent child or student will be increased to $3,306.

This measure is estimated to have a cost to revenue of $280.0 million over the forward estimates period.