A Clear Direction Financial Planning
Level 24, 10 Eagle Street, Brisbane QLD 4000
scottk@acleardirection.com.au
(07) 3379 6068
ABN: 56 243 688 349

2010 Personal Finance Budget Summary

The budget has provided a number of significant changes impacting on financial planning strategies. These have been outlined in this summary. The major changes include:

- Confirmation of income tax changes from July 1st 2010 increasing the effective tax free threshold from $15,000 to $16,000 for those earning $30,000 or less, the bottom of the 30% marginal tax rate threshold increasing from $35,000 to $37,000 and the current 38% marginal tax rate being reduced to 37%.

- A 50% discount commencing July 1st, 2011 on the tax payable on the first $1,000 of interest income generated by bank, credit union and building society accounts along with income from bonds, debentures and annuity products.

- A $500 standard deduction for work related expenses starting 2012-13, increasing to $1,000 for 2013-14 to simplify tax returns and lead to tax savings for many individuals.

- Superannuation guarantee contributions to rise from the current 9% to 12% by July 2019.

- A $500 superannuation tax rebate, commencing July 1st, 2012, of the contributions tax for those with incomes of up to $37,000.

- Superannuation co-contribution matching rate from the government to remain at 100% up to a maximum of $1,000 p.a.

- The superannuation guarantee age limit to rise from 70 to 75 starting July 1st 2013.

- A reduction in the company tax rate from 30% to 29% in 2013-14 and 28% in 2014-15.

- The company tax rate reductions to be brought forward for small businesses with the rate of 28% applicable from 2012-13.

- Small businesses to be able to immediately write off asset purchases of less than $5,000 compared to the current limit of $1,000.

- A permanent extension from 1st July 2012 of the eligibility for those over 50 to receive $50,000 of concessional contributions into super p.a. as long as superannuation balances do not exceed $500,000.

- The Net Medical Expenses Tax Offset to increase from $1,500 to $2,000

Each of the above items has been addressed in a little more detail in the following sections.

Income Tax - Cuts Untouched

The government have left unchanged the promised income tax changes for the next financial year including increases to the Low Income Tax Offset

Current			**From 1 July 2010**	
Taxable income ($)	Rate (%)		Taxable income ($)	Rate (%)
0 - 6000	0		0 - 6000	0
6,001 - **35,0000**	15		6,001 - **37,000**	15
35,001 - 80,000	30		**37,001**- 80,000	30
80,001- 180,000	**38**		80,001- 180,000	**37**
180,001 +	45		180,001 +	45
Low Income Tax Offset (LITO)	$1,350			$1,500
LITO Maximum Threshold	$63,750			$67,500
Effective tax free threshold (incomes less than $30,000)	$15,000			$16,000

To break this down, the following table sets out the tax payable on a range of assessable income levels:

Income Tax on:	Current Year	2010/11
$30,000	$2,250	$2,100
$40,000	$4,900	$4,450
$50,000	$8,300	$7,850
$60,000	$11,700	$11,250
$70,000	$14,850	$14,550
$80,000	$17,850	$17,550
$90,000	$21,650	$21,250
$100,000	$25,450	$24,950
$110,000	$29,250	$28,650
$120,000	$33,050	$32,350
$130,000	$36,850	$36,050
$140,000	$40,650	$39,750
$150,000	$44,450	$43,450
$160,000	$48,250	$47,150
$170,000	$52,050	$50,850
$180,000	$55,850	$54,550

50% Discount on Tax Payable on the First $1,000 of Interest Income

From 1 July 2011, the Government will provide individuals with a 50 per cent tax discount on up to $1,000 of interest earned including interest earned on deposits held in authorised deposit taking institutions, bonds, debentures and annuity products.

The discount will be available for interest income earned directly as well as indirectly, such as via a trust or managed investment scheme.

The implication of this change is for significantly improved after tax returns as shown by the following table:

Indicative Investment Value		**After Tax Return on Marginal Tax Rate**					
@ 6% interest	**Interest Earned**	**16.50%**			**31.50%**		
		Now	Future	Improvement in effective yield	Now	Future	Improvement in effective yield
$16,666.67	$1,000	$835.00	$917.50	**0.50%**	$685.00	$842.50	**0.95%**
$33,333.33	$2,000	$1,670.00	$1,752.50	**0.25%**	$1,370.00	$1,527.50	**0.47%**
$50,000.00	$3,000	$2,505.00	$2,587.50	**0.17%**	$2,055.00	$2,212.50	**0.32%**
$66,666.67	$4,000	$3,340.00	$3,422.50	**0.12%**	$2,740.00	$2,897.50	**0.24%**
$83,333.33	$5,000	$4,175.00	$4,257.50	**0.10%**	$3,425.00	$3,582.50	**0.19%**
@ 6% interest	**Interest Earned**	**38.50%**			**46.50%**		
		Now	Future	Improvement in effective yield	Now	Future	Improvement in effective yield
$16,666.67	$1,000	$615.00	$807.50	**1.16%**	$535.00	$767.50	**1.40%**
$33,333.33	$2,000	$1,230.00	$1,422.50	**0.58%**	$1,070.00	$1,302.50	**0.70%**
$50,000.00	$3,000	$1,845.00	$2,037.50	**0.39%**	$1,605.00	$1,837.50	**0.47%**
$66,666.67	$4,000	$2,460.00	$2,652.50	**0.29%**	$2,140.00	$2,372.50	**0.35%**
$83,333.33	$5,000	$3,075.00	$3,267.50	**0.23%**	$2,675.00	$2,907.50	**0.28%**

This change will lead to taxpayers having a reduced adjusted taxable income for the purpose of determining eligibility for government payments and other concessions. This will result in some individuals and families becoming eligible for government payments or eligible for larger government payments such as the Family Tax Benefit, Baby Bonus, Child Care Benefit, Education Tax Refund, Commonwealth Seniors Health Card (CSHC) and the Pensioner Supplement (which is linked to eligibility for the CSHC).

Strategy Thought
This provides an incentive to hold more investments in cash and other defensive investments as the effective after tax return is significantly improved especially at lower levels of holdings. For those receiving government payments limited through an income test, this change may also lead to improved access to these payments.

Standard Deduction for Work Related Expenses

The Government will provide individual taxpayers with a standard deduction of $500 for work-related expenses and the cost of managing tax affairs from 1 July 2012. From 1 July 2013 the Government will increase the standard deduction to $1,000.

Those taxpayers with deductible expenses greater than the standard deduction amount will still be able to claim their higher expenses, in-lieu of claiming the standard deduction amount.

This standard deduction may allow extended access to government payments and other concessions because the standard deduction will reduce individuals' and families' adjusted taxable income for the purpose of determining their eligibility for payments and other concessions. This will make some individuals and families eligible for payments or eligible for a larger payment.

Strategy Thought
You will need to review previous tax returns to determine whether this change will likely provide you with an improved after tax outcome. If so, it may also lead to reduced tax accountant fees if you are able to complete your own tax return.

Superannuation Guarantee Contributions to Rise from 9 to 12%

The Government will increase the superannuation guarantee (SG) rate from 9 per cent to 12 per cent, with increments of 0.25 percentage points in the first two years, and 0.5 percentage points thereafter. The increase will be phased in from 1 July 2013 to 1 July 2019, as shown below:

Year	Rate (%)
2013-14	9.25%
2014-15	9.50%
2015-16	10.00%
2016-17	10.50%
2017-18	11.00%
2018-19	11.50%
2019-20	12.00%

Strategy Thought
This change will allow individuals to reconsider their retirement planning options as well as re-assessing intermediate goals and how to fund each.

Superannuation Contributions Tax Rebate for Individuals Earning up to $37,000 p.a.

The Government will provide a superannuation contributions tax rebate of up to $500 annually with effect from the 2012-13 income year.

Currently all concessional superannuation contributions are taxable in the fund at a flat rate of 15 per cent. The amount payable under this measure will be calculated by applying a 15 per cent rebate of tax to the concessional contributions made by or for individuals on adjusted taxable incomes of up to $37,000 (not indexed), with an annual maximum amount payable of $500 (not indexed). The rebate will be paid to the individual's superannuation fund to directly boost their retirement savings.

Concessional superannuation contributions made in the 2012-13 income year and later income years will be eligible, with the first Government contribution paid in the 2013-14 financial year.

Increasing Concessional Contributions Cap for Individuals over 50 with Superannuation Balances less than $500,000

From 1 July 2012, the Government will allow individuals aged 50 and over with total superannuation balances below $500,000 to make up to $50,000 in concessional superannuation contributions. This doubles the cap of $25,000 (indexed) which is scheduled to apply from 1 July 2012.

The Government are yet to provide details on the operation of the $500,000 threshold.

Strategy Thought
This provides an incentive for individuals who are aged 50 and above, or approaching this age bracket, to consider alternatives to keep their superannuation balance below $500,000 and thus remain eligible for the $50,000 of annual concessional contributions rather than the standard capped amount of $25,000.

A key strategy to consider will be to implement superannuation contributions splitting strategies to direct superannuation contributions to a spouse who either has a much lower superannuation balance and / or who will not be able to take advantage of the increased concessional contributions threshold after turning age 50.

Careful consideration should also be given to where any personal (non-concessional) contributions are made so as to not push an individual's balance above $500,000.

Superannuation Co-contribution Matching Rate to Remain at 100% up to a Maximum of $1,000 p.a.

The matching rate is to remain at 100% and the maximum co-contribution payable on an individual's personal non-concessional contribution is proposed to be permanently retained at $1,000 p.a. This is a change from last year's budget which indicated that the matching rate would rise back to the original 150% level with a maximum payment of $1,500 per year.

Superannuation Guarantee Age Limit to Rise from 70 to 75

The Government will raise the superannuation guarantee (SG) age limit from 70 to 75, with effect from 1 July 2013. Currently, the SG only applies to people aged up to 70. In contrast, employers can make voluntary deductible superannuation contributions for employees under 75, and self-employed people can make deductible contributions until they turn 75.

This measure will make workers aged 70 to 74 eligible to have SG contributions made on their behalf for the first time, and align the SG age limit with the age limit for voluntary and self-employed contributions.

<u>Strategy Thoughts</u>
This change may provide an added incentive to continue to work later in life either full or part time.

Reduction in the Company Tax Rate

The Government will reduce the company tax rate from 30 per cent to 28 per cent in two steps, from the 2013-14 income year. The company tax rate will be reduced to 29 per cent for the 2013-14 income year and to 28 per cent from the 2014-15 income year.

<u>Investment Portfolio Impact</u>
A decrease in the company tax rate from 30% to 28% does not sound all that exciting but it will make a difference to the bottom line of many companies. Putting to one side those hit by the additional resource tax, the reduction in company tax will make owning shares more attractive.

For example, if a company makes a profit of $1 million they pay tax on this profit of $300,000, which leaves them with $700,000 of earnings after tax. Once the tax is cut to 28%, tax on every $1 million of profit will be $280,000, with $720,000 of earnings after tax. This is effectively an ongoing increase in earnings after tax of nearly 3% – an attractive outcome for shareholders.

If we take this one step further, the flow through to dividends might be even more attractive. Notwithstanding a credit crunch, companies tend to pay about two-thirds of their earnings as dividends while retaining one-third to invest in new projects, pay down debt and pursue other growth opportunities.

Using the same example, if the company keeps a third of the $700,000 to fund new projects ($233,000), that leaves $467,000 to be distributed to shareholders as dividends. Under the 28% company tax regime, earnings after tax increases from $700,000 to $720,000.

Assuming that companies retain the same dollar amount for investment ($233,000), this leaves $487,000 to be distributed to shareholders as a cash dividend. This is an additional $20,000 or a nice boost to cash dividends of 4.3%. After the recent bout of "dividend shrink", this is something to look forward to!

The bad news is that there will almost certainly be a reduction in franking credits that will eat into some of this increased dividend return. That is because a franking credit is basically a refund of the tax paid at the company level. The good news is that shareholders will still be ahead as the increase in dividend will be greater than the decrease in franking credits.

Early Start to the Company Tax Rate Cut for Small Business Companies

The Government will cut the company tax rate for small business companies to 28 per cent from the 2012-13 income year. As a result, small business companies will have a lower tax rate than other companies until the reduction in the general company tax rate to 28 per cent in 2014-15.

<u>Strategy Thought</u>
This change provides further incentives for small business to move to a company structure especially if assessable income being generated by the business for each business owner is greater than $37,000 which would push them into the 31.5% tax bracket. The change will also impact payment strategies employed by small businesses.

Small Business Asset Write-Off & Simplified Pooling of Depreciable Assets

The Government will allow small businesses to immediately write off all assets costing less than $5,000 and will allow most other assets (not including buildings) to be depreciated in a single pool at a 30 per cent rate. This measure will take effect from the 2012-13 income year.

The existing depreciation concessions available to small businesses allow the immediate write-off of assets costing less than $1,000 and to depreciate other assets in two pools, depending on the life of the asset.

Net Medical Expenses Tax Offset

The Government will increase the threshold above which a taxpayer may claim the net medical expenses tax offset from $1,500 to $2,000 and commence annually indexing the threshold to the Consumer Price Index, with effect from 1 July 2010. The first indexation adjustment to the threshold will take place on 1 July 2011.

The NMETO currently allows taxpayers to receive a tax offset equal to 20 per cent of net unreimbursed eligible medical expenses above $1,500.

Summary of Major Strategy Considerations

In a nutshell these are the possible strategy modifications arising from this year's budget:

- Reconsidering the extent of cash and defensive asset classes in your overall investment portfolio and the added benefits due to the tax discount on the first $1,000 of interest income.
- Assessing the impact of the standard deduction for work related expenses for the 2012-13 financial year.
- Assessing the impact of the increase in SG contributions from 9 to 12% and how this will impact your ability to reach your retirement and prior to retirement goals.
- Consideration of a superannuation contributions splitting strategy for those who might benefit from being able to receive extra concessional contributions into super from the age of 50 and also careful consideration of whose account to place personal contributions for couples.
- For those turning 70 after the 1st of July 2013, consider the impact of the increase in the superannuation guarantee age limit from 70 to 75.
- Small business owners to reconsider business structures due to the impact of the company tax rate reduction.
- Small business owners to reconsider asset purchase and depreciation of assets planning.

Concluding Comments

This time last year we commented on concerns about the undermining of the confidence in the superannuation system through seemingly continual changes. The changes announced this year have continued to reflect the history of superannuation changes that have 'favoured' the superannuation investor. Changes such as:

- The initial introduction of a compulsory, tax advantaged, superannuation system
- The reduction of the 'superannuation surcharge' for high income earners
- The introduction of new superannuation pension formats
- The introduction of tax free superannuation withdrawals after the age of 60
- Relaxation of the rules for withdrawing superannuation
- And now:
  - The increase in the SG contributions
  - Tax rebate of superannuation contributions tax for lower income earners
  - Improved accessibility to concessional contributions for those aged 50 and above
  - SG contribution age limit increase from 70 to 75

These are all positive developments and should improve confidence in the system moving forward.

This document has been prepared as a brief summary of the 2010 Federal Budget as it impacts on personal finances. It is a publication of A Clear Direction Financial Planning. It contains general financial information. Readers should check this information with a professional financial adviser before acting on any of the material contained in this document.