

FEDERAL BUDGET 2018

KEY ANNOUNCEMENTS / 9 MAY 2018



On 8 May 2018, Treasurer Scott Morrison delivered Australia’s Federal Budget for 2018-19. The Budget aims to bring a further improvement to Australia’s fiscal position, reflecting the Government’s focus on fiscal discipline to achieve budget surpluses and improved receipts from stronger economic growth.

In the following update, we provide a summary of the key announcements from the Budget from the perspective of investors and briefly outline the potential economic impacts.

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Changes to personal income tax

The Government's personal income tax plan lowers taxes, simplifies the system and means that roughly 94% of all taxpayers are projected to pay no more than 32.5 cents in the dollar in 2024–25. This plan helps to protect against bracket creep and builds on the 2016–17 Budget changes.

The personal income tax plan will be delivered in three steps

Step 1: Tax relief for low and middle-income earners—A new tax offset, in addition to the Low-Income Tax Offset, will provide tax relief to low and middle-income earners.

Step 2: Protecting middle-income Australians from bracket creep—The top thresholds of both the 19% and 32.5% tax brackets are being increased.

Step 3: Making personal taxes simpler and flatter—From 1 July 2024, the 37% bracket will be removed entirely with the top marginal tax rate of 45% applying above \$200,000.

New personal tax rates and thresholds (excluding Medicare)

| RATE (%) | INCOME RANGE (\$) | | | |
|--------------------------------|------------------------|---------------------------------|---------------------------------|---------------------------------|
| | CURRENT TAX THRESHOLDS | NEW THRESHOLDS FROM 1 JULY 2018 | NEW THRESHOLDS FROM 1 JULY 2022 | NEW THRESHOLDS FROM 1 JULY 2024 |
| Tax free | 0-18,200 | 0-18,200 | 0-18,200 | 0-18,200 |
| 19 | 18,201-37,000 | 18,201-37,000 | 18,201-41,000 | 18,201-41,000 |
| 32.5 | 37,001-87,000 | 37,001-90,000 | 41,001-120,000 | 41,001-200,000 |
| 37 | 87,001-180,000 | 90,001-180,000 | 120,001-180,000 | |
| 45 | >180,000 | >180,000 | >180,000 | >200,000 |
| INCOME TAX OFFSETS (\$) | | | | |
| Low and middle | | Up to 530 | | |
| Low | Up to 445 | Up to 445 | Up to 645 | Up to 645 |

Medicare levy

The Government will increase the Medicare levy low-income thresholds for singles, families, seniors and pensioners from the 2017-18 income year to take account of recent CPI movements. The Medicare levy will be retained at 2% per annum, with the scrapping of the planned 0.50% increase.

Corporate tax and small business

Companies with annual turnover less than \$10 million had their tax rate cut to 27.5% in 2016-17. This lower corporate tax rate was extended to companies with annual turnover less than \$25 million in 2017-18 and will extend to companies with annual turnover less than \$50 million from 1 July 2018.

For businesses with aggregated annual turnover less than \$10 million, the Government will extend the 2015-16 Budget measure *Growing Jobs and Small Business—expanding accelerated depreciation for small businesses* by a further 12 months to 30 June 2019. This initiative allows small businesses to immediately deduct purchases of eligible assets costing less than \$20,000 first used or installed ready for use by 30 June 2019.

Superannuation

Work test exemption for recent retirees

The Government will introduce an exemption from the 'work test' for voluntary contributions to superannuation by people aged 65-74 who have superannuation balances below \$300,000. The exemption will be applicable in the first year that they do not meet the work test requirements (a minimum of 40 hours in any 30-day period in the financial year).

Capping passive fees, banning exit fees and small super accounts

From 1 July 2019, the Government will introduce a 3% annual cap on passive fees charged by superannuation funds on accounts with balances below \$6,000 and will ban exit fees on all superannuation accounts. The Government will also require that all inactive superannuation accounts, where balances are below \$6,000, are transferred to the Australian Taxation Office (ATO). The ATO will expand its data-matching processes to proactively reunite these inactive superannuation accounts with the member's active account where possible.

Changes to insurance in superannuation

From 1 July 2019, the Government will change the default insurance arrangements for certain superannuation members to an opt-in basis. This will apply to those who have low balances of less than \$6,000, who are under the age of 25 years, and whose accounts have not received a contribution in 13 months and are inactive. This will ensure low balances are not eroded by premiums on insurance policies they do not need or are not aware of.

Increasing the maximum number of members in SMSFs

From 1 July 2019, the Government will increase the maximum number of allowable members in new and existing self-managed superannuation funds (SMSFs) and small APRA funds from four to six. This will provide greater flexibility for joint management of retirement savings, particularly for large families.

Preventing inadvertent concessional cap breaches

From 1 July 2018, the Government will allow individuals whose income exceeds \$263,157 and who have multiple employers to nominate that their wages from certain employers are not subject to the superannuation guarantee (SG). This will allow individuals to avoid unintentionally breaching the \$25,000 annual concessional contributions cap as a result of multiple compulsory SG contributions.

Three-yearly audit cycle for some SMSFs

From 1 July 2019, the Government will change the annual audit requirement to a three-yearly requirement for SMSFs that have a history of good record-keeping and compliance.

Tax integrity

Clarifying the operation of the Division 7A integrity rule

From 1 July 2019, the Government will ensure that unpaid present entitlements (UPE) come within the scope of Division 7A of the *Income Tax Assessment Act*. This will apply where a related private company is made entitled to a share of trust income as a beneficiary but has not been paid that amount, known as a UPE. This measure will ensure the UPE is either repaid to the private company over time as a complying loan or subject to tax as a dividend.

Government to deny deductions for vacant land

The Government will deny deductions for expenses associated with holding vacant land. This addresses concerns that deductions are being improperly claimed for expenses, such as interest costs related to holding vacant land where the land is not genuinely held for the purpose of earning assessable income. It will also reduce tax incentives for land banking, which deny the use of land for housing or other development. This measure will take effect from 1 July 2019.

Concessions in relation to partnerships

From 7:30PM (AEST) on 8 May 2018, partners that alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership will no longer be able to access the small business capital gains tax concessions in relation to these rights.

Extending anti-avoidance rules for circular trust distributions

The Government will extend to family trusts a specific anti-avoidance rule that applies to other closely-held trusts that engage in circular trust distributions. Currently, where family trusts act as beneficiaries of each other in a 'round-robin' arrangement, a distribution can be ultimately returned to the original trustee in a way that avoids any tax being paid on that amount. Tax will be imposed on such distributions at a rate equal to the top personal tax rate plus the Medicare levy.

Taxation of testamentary trusts

From 1 July 2019, the concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets that are transferred from the deceased estate. This is to counteract assets that are unrelated to the deceased estate being inappropriately injected into a testamentary trust.

What does it mean for investors?

The framing of this year's Federal Budget benefited from a much better revenue backdrop relative to prior years. Somewhat reflecting a typical 'pre-election budget', there were few nasties for either investors or the economy. The Budget's revenue uplift largely reflects the impact of the recent strength of the jobs market, with over 430,000 jobs created over the past year (lowering welfare payments), together with higher company profits (reflecting higher-than-expected commodity prices).

Consequently, Treasurer Morrison steered a path between ensuring the fiscal position returns to surplus before 2020-21 (now expected a year earlier in 2019-20) and also delivering some support to the economy. This year's Budget focuses on modest near-term personal income tax cuts (with a significant seven-year reform plan), support for small business investment together with an ongoing focus on road and rail infrastructure spending and previously announced company tax cuts. The Budget also announced extra spending on health, medical research, aged care and the environment.

Looking forward, the Budget is likely to be relatively well received by markets. Sectors linked to the consumer and small business capex, health and infrastructure are likely to be seen to benefit most from the Budget. Some budget measures were less positive for aged care, life insurers and companies facing tighter access to research and development (R&D) tax breaks. A lower peak in government debt issuance may marginally support fixed income markets. The Government's earlier-than-expected path to surplus has contributed to credit agencies reaffirming Australia's AAA credit rating.

Budget to moderately support consumer sector

The Budget's centre-piece is a seven-year plan to reduce personal income taxes, significantly boosting take-home pay by 2024. However, near-term impacts are quite modest. Significantly, the Government has also cancelled the 0.5% increase to the Medicare Levy. Further, the extension of the small business instant asset write-off for investment up to \$20,000 should support near-term demand for business motor vehicles, office equipment, technology products and the like. Stronger consumer spending may also support jobs and housing activity across the economy.

New policies around protecting (low-balance) superannuation

The Budget includes a range of measures, largely targeted at protecting low balance superannuation accounts. These include a ban on fund exit fees for all accounts from mid-2019, and a 3% cap on passive fees for accounts with balances below \$6,000. Further, new policy shifts insurance options within superannuation from opt-out to opt-in for under-25s, a potential negative for life insurers. The ATO is also being given the capacity to actively match lost super accounts to reduce fees paid.

Additional funding for hospitals, home care and pharmaceuticals

The Budget includes an increase in hospital funding of \$30 billion over five years from 2020-21. The Budget also includes \$1.4 billion for new and amended listings on the PBS, including medicines to treat spinal muscular atrophy and breast cancer. The Government will also encourage a greater use of generic and biosimilar medicines. Increased funding to in-home care will enable a further 14,000 aged care recipients to receive their care at home. This targets a reduction in the current waiting list that currently exceeds 60,000 and will likely have a limited impact on aged care providers.

Ongoing focus on infrastructure and new research spending

The infrastructure sector will benefit from a continued significant \$75 billion 10-year spending plan. The Budget highlights \$24.5 billion of new nationally significant transport projects. These include up to \$5 billion for the Melbourne airport rail link, around \$3 billion for projects in Western Australia, and almost \$2 billion for the Pacific Highway. The ongoing strength in public works will continue to positively impact private sector companies and business services linked to it (including the materials sector).

The Government is also investing an additional \$1.9 billion over 12 years in national research infrastructure across health, manufacturing and agriculture, as well as \$1.3 billion to support Australian health and medical research, including a 10-year \$500 million commitment to the Genomics Health Futures Mission.

Strong focus on integrity measures to boost Budget funding

In addition to the revenue uplift from a stronger economy, the Government is relying on a range of significant measures to reduce expenditure and boost revenue. These include targeting the black economy, such as banning cash transactions in excess of \$10,000 and combating illicit tobacco sales along with other measures to ensure tax obligations are paid.

R&D tax breaks cut back

The Budget contains an overhaul of the R&D tax incentive, the largest component of government spending on R&D. The R&D tax incentive has two core components—a refundable tax offset for businesses with turnover of less than \$20 million; and a non-refundable offset for those above the \$20 million threshold. Under the changes, the size of the tax benefits flowing to companies with annual turnover of more than \$20 million will focus on the intensity of R&D spending. The aim is to reduce assistance for research spending that would have occurred without any public assistance.

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