



# Technical Update

## 2010 Federal Budget summary

11 May 2010

While the 2010 Federal Budget contained few surprises, some taxation, superannuation and social security changes were announced that will impact your clients.

### Summary of key announcements

The key proposals announced in the Federal Budget include:

- individuals will only need to include 50% of interest income of up to \$1,000 from certain investments in their tax return
- taxpayers will have the option to claim a standard deduction of \$500 in 2012/13, increasing to \$1,000 in 2013/14
- the benchmark interest rate for capital protected products will retrospectively be the indicator rate plus 100 basis points
- the maximum co-contribution matching rate and payment amount will remain at 100% and \$1,000 respectively
- super funds will be eligible to claim a deduction when paying terminal medical condition benefits
- the Commissioner will be able to exercise discretion in relation to excess contributions tax before an assessment is issued, and
- changes will be made to improve the accessibility of Special Disability Trusts.

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## Henry review proposals confirmed

The Government also confirmed the key proposals announced earlier this month in response to the Henry review of taxation. These include:

- the superannuation guarantee (SG) rate will increase gradually from 9% to 12% from 1 July 2013
- the SG contribution age limit will increase from 70 to 75 from 1 July 2013
- a Government super contribution of up to \$500 pa will be made for people earning up to \$37,000 pa from 1 July 2012 to effectively refund contributions tax
- the concessional contribution cap will be reinstated to \$50,000 pa from 1 July 2012 for people aged 50 or over with super balances below \$500,000
- the company tax rate will gradually reduce to 28% by 1 July 2014 (and two years earlier for eligible small businesses)
- very generous depreciation rules will apply to small businesses from 1 July 2012, and
- a 40% Resource Super Profit Tax will be introduced from 1 July 2012.

More information on these proposals is contained in the ['Government's response to Henry review'](#), issued on 3 May 2010.

## Personal taxation changes

### Interest income tax discount

*Date of effect: 1 July 2011*

Individuals will be eligible for a 50% tax discount on up to \$1,000 of interest earned from 1 July 2011 on:

- deposits with authorised deposit taking institutions, bonds, debentures and annuity products, and
- the above investments where held indirectly via trusts or managed funds.

This discount will reduce the individual's adjusted taxable income (ATI), which may in turn increase their eligibility for payments and entitlements such as the Family Tax Benefit, Baby Bonus and the Commonwealth Seniors Health Card. The table below shows the tax saving for a range of income levels where \$1,000 in interest is earned in 2011/12.

ATI excluding \$1,000 interest	Without 50% tax discount		With 50% tax discount		
	ATI including \$1,000 interest	Tax payable	ATI including \$1,000 interest	Tax payable	Tax saving
\$20,000	\$21,000	\$750	\$20,500	\$675	\$75
\$40,000	\$41,000	\$4,790	\$40,500	\$4,620	\$170
\$60,000	\$61,000	\$11,590	\$60,500	\$11,420	\$170
\$80,000	\$81,000	\$17,920	\$80,500	\$17,735	\$185
\$100,000	\$101,000	\$25,320	\$100,500	\$25,135	\$185
\$120,000	\$121,000	\$32,720	\$120,500	\$32,535	\$185
\$140,000	\$141,000	\$40,120	\$140,500	\$39,935	\$185
\$160,000	\$161,000	\$47,520	\$160,500	\$47,335	\$185
\$180,000	\$181,000	\$55,000	\$180,500	\$54,775	\$225
\$200,000	\$201,000	\$64,000	\$200,500	\$63,775	\$225

**Note:** This analysis takes into account the personal tax rate and threshold changes, as well as the enhancements to the low income tax offset that are scheduled to take effect on 1 July 2010 (see page 3) and ignores the Medicare levy.

*Comments:*

- This measure will provide a greater incentive to save in eligible deposit products.
- First home savers are likely to be better off saving for a deposit using a First Home Saver Account and receiving the co-contribution of 17%, following the removal of the requirement to roll the funds into super if a first home is purchased within four years (see below).
- For individuals with a mortgage, depositing cash in a 100% offset account is still likely to be the better option. This is because the cash will reduce the home loan balance on which interest is calculated. As a result, the cash will effectively 'earn' home loan interest rates and no tax will be payable on the interest savings.
- Many retirees will find they are currently not paying any tax on interest income (and other sources of taxable income) when various tax offsets, such as the low income tax offset and Senior Australians tax offset (SATO) are taken into account. For example, a single person not using pension investments who is eligible for SATO can receive an income of up to \$30,685 in 2010/11 without paying any tax – see page 4.

## Standard deduction limits

*Date of effect: phased in from 1 July 2012*

A standard deduction of \$500 will apply to work-related expenses and the cost of managing tax affairs from 1 July 2012, increasing to \$1,000 from 1 July 2013. Those taxpayers who wish to claim a greater deduction will still be able to claim their higher expenses in lieu of the standard deduction.

## First Home Saver Account

*Date of effect: For houses purchased after royal ascent of legislation*

A minor amendment has been made to the First Home Saver Account (FHSA), allowing individuals to roll the balance into their mortgage on the purchase of an eligible first home after a minimum qualifying period. Draft amendments to the legislation will be released for consultation. Under the original legislation, home purchases prior to the end of a four year period resulted in the balance of the FHSA being rolled into super.

## Personal tax rate/threshold changes confirmed

*Date of effect: 1 July 2010*

The previously announced changes to the personal income tax rates and thresholds have been confirmed. These changes are highlighted in **bold** below.

Thresholds in 2009/10	Tax rate <sup>1</sup>	Thresholds in 2010/11 and beyond	Tax rate <sup>1</sup>
\$0 - \$6,000	0%	\$0 - \$6,000	0%
\$6,001 - \$35,000	15%	\$6,001 - <b>\$37,000</b>	15%
\$35,001 - \$80,000	30%	<b>\$37,001</b> - \$80,000	30%
\$80,001 - \$180,000	38%	\$80,001 - \$180,000	<b>37%</b>
\$180,001 +	45%	\$180,001 +	45%

## Low income tax offset enhancement confirmed

*Date of effect: 1 July 2010*

The increase in the maximum low income tax offset to \$1,500 per year from 1 July 2010 has also been confirmed. As a result, the amount of tax-free income low-income earners can receive each year (and the upper limit to which a partial low income tax offset can be claimed) will increase to \$16,000 and \$67,500 respectively.

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<sup>1</sup> Doesn't include the Medicare Levy.

	In 2009/10	In 2010/11 and beyond
Maximum offset	\$1,350	\$1,500
Upper income threshold <sup>2</sup>	\$63,750	\$67,500
Maximum tax-free income	\$15,000	\$16,000

## Tax payable and potential tax savings

*Date of effect: 1 July 2010*

The following table shows the amount of tax payable and tax saved in 2010/11 for a range of taxable incomes, when compared to the current (2009/10) financial year.

Taxable income	Tax payable <sup>3</sup> in 209/10	Tax payable <sup>3</sup> in 2010/11	Tax saved
\$20,000	\$750	\$600	\$150
\$40,000	\$4,900	\$4,450	\$450
\$60,000	\$11,700	\$11,250	\$450
\$80,000	\$17,850	\$17,550	\$300
\$100,000	\$25,450	\$24,950	\$500
\$120,000	\$33,050	\$32,350	\$700
\$140,000	\$40,650	\$39,750	\$900
\$160,000	\$48,250	\$47,150	\$1,100
\$180,000	\$55,850	\$54,550	\$1,300
\$200,000	\$64,850	\$63,550	\$1,300

## Tax-free incomes for older Australians

*Date of effect: 1 July 2010*

People aged 60 or over will still be able to receive an unlimited tax-free income from pension investments commenced from a taxed super fund. The table below shows the amount of taxable income that can be received tax-free by older Australians in other circumstances.

People who are:	Tax-free incomes <sup>4</sup>	
	2009/10	2010/11 and beyond
Aged 55 to 59 using pension investments <sup>5</sup> :		
• Singles	\$45,789	\$48,158
• Per member of a couple	\$45,789	\$48,158
Eligible for SATO not using pension investments:		
• Singles	\$29,867	\$30,685
• Per member of a couple	\$25,680	\$26,680

2 The lower income threshold will remain at \$30,000.

3 Doesn't include the Medicare Levy, or tax offsets other than the low income tax offset.

4 Doesn't include the Medicare Levy, but includes the low income tax offset and SATO, where applicable.

5 Assumes no income from other sources is received.

## Instalment warrants and CGT

*Date of effect: 1 July 2007*

As previously announced, with effect from 1 July 2007, the Government will amend the tax law of qualifying instalment warrants to provide certainty for investors by treating them as the owner of the underlying asset for tax purposes. The measure will also provide certainty from a tax perspective for non-recourse borrowings by super fund trustees.

## Capital protected borrowings

*Date of effect: 13 May 2008*

In the 2008 Budget, it was proposed:

- the benchmark interest rate for capital protected borrowings be lowered to the RBA indicator rate for standard variable housing loans, and
- any cost above the benchmark rate would be taken to be the cost of 'protection', which would not be deductible and would be added to the cost base.

This change was never legislated. It's now proposed, with retrospective effect, that the benchmark interest rate will be the indicator rate plus 100 basis points.

## Medical expense offset claim threshold increase

*Date of effect: from 1 July 2010*

The net medical expenses tax offset of 20% will apply to net medical expenses above a threshold of \$2,000 in 2010/11, instead of the current level of \$1,500. The threshold will also be indexed to the Consumer Price Index, starting on 1 July 2011.

## Child care rebate cap reduced

*Date of effect: 1 July 2010*

The annual Child Care Rebate will be capped at \$7,500 per child (reduced from the current cap of \$7,778), and indexation will be paused for four years from 1 July 2010. Out of pocket expenses will continue to be rebated at 50% of the annual cap.

## Superannuation changes

### Reduced Government co-contributions

*Date of effect: 1 July 2012*

The Government will permanently retain the matching rate for co-contributions at 100% and the maximum co-contribution that is payable at \$1,000. This overrides the measure announced in last year's Federal Budget to reduce the matching rate and maximum co-contribution temporarily (as per the following table).

Contribution year	Before Budget		After Budget	
	Matching rate	Max. co-cont	Matching rate	Max. co-cont
2009/10	100%	\$1,000	100%	\$1,000
2010/11	100%	\$1,000	100%	\$1,000
2011/12	100%	\$1,000	100%	\$1,000
2012/13	125%	\$1,250	100%	\$1,000
2013/14	125%	\$1,250	100%	\$1,000
2014/15 onwards	150%	\$1,500	100%	\$1,000

### Example: Impact of co-contribution proposals

Max, aged 55, is employed and earns \$25,000 pa. He'd like to invest \$1,000 a year for five years (from 1 July 2010) and is considering:

- investing outside super in a unit trust, or
- investing inside super and receiving a Government co-contribution each year.

As the table below shows, although Max will still be better off investing in super, he'll have \$1,058 less for his retirement as a result of the co-contribution proposals.

	Invest outside super	Invest in super (before Budget)	Invest in super (after Budget)
Co-contribution – year one	Nil	\$897	\$897
Value of investment after five years	\$6,019	\$12,892	\$11,834

**Assumptions:** A five-year comparison based on an after-tax investment of \$1,000 pa. The super investment (only) attracts a co-contribution. The lower income threshold of \$31,920 has been used in the first three years (see below) and has been indexed at 3% pa in years four and five. The pre-tax investment return is 8% pa (split 3.5% income and 4.5% growth). Investment income is franked at 30%. All figures are after income tax (at 15% in super and 16.5% outside super) and capital gains tax (including discounting). These rates are assumed to remain constant over the investment period. No lump sum tax is payable by Max as he will be age 60 in five years time.

### Indexation of co-contribution income thresholds

*Date of effect: 1 July 2010*

It's proposed the indexation applied to the shade-out and cut-out income thresholds will be frozen for 2010/11 and 2011/12. In these years, eligible individuals will receive the full co-contribution if their adjusted taxable income (ATI) is less than \$31,920 and a partial co-contribution if their ATI is less than \$61,920.

### Deductibility of terminal medical condition benefits

*Date of effect: 16 February 2008*

The Government will extend the range of benefits that are deductible to complying super funds and RSA providers to include terminal medical condition (TMC) benefits. The measure will have effect from 16 February 2008, the date the TMC condition of release was introduced.

Currently, deductions are only allowable under section 295-470 of the ITAA 1997 for the cost of providing benefits relating to the death, permanent incapacity and temporary incapacity conditions of release, but not those relating to the TMC condition of release.

The deduction is equivalent to the Future Service Element (FSE) portion of a TMC benefit paid. The following formula is used to calculate the FSE:

$$\text{FSE} = \text{Benefit Amount} \times \frac{\text{Future Service Days (FSD)}}{\text{Total Service Days (TSD)}}$$

This deduction is most likely to be used by SMSFs, as large funds will generally claim a deduction for death or disability premiums each year, which precludes them from claiming this deduction.

### Example: Calculating deduction for a TMC benefit

James is a SMSF member and is paid a benefit due to a TMC on 11/5/2010 (aged 40). His fund details are as follows:

- TMC benefit of \$500,000
- Eligible service date: 11/05/2000
- Date of birth: 11/05/1970 (ie he would have been age 65 on 11/05/2035).

After his death, the remaining trustees elect to claim a deduction equal to the FSE of the payment, which is calculated as follows:

$$\begin{aligned}\text{Deduction} &= \text{TMC payment} \times \text{FSD/TSD} \\ &= \$500,000 \times 9,132/12,784 \\ &= \$357,165\end{aligned}$$

This amount can be carried forward for use in future years to offset tax payable by the fund (including contributions tax) until it's exhausted.

## Loss relief for merging super funds extended

The Government has extended the loss relief for super funds that merge to arrangements where existing funds merge into a new fund, with effect from 24 December 2008. The loss relief for super funds that merge is a temporary measure which removes certain income tax impediments to fund mergers until 30 June 2011. The extension of the loss relief to mergers into new funds increases the flexibility of the measure, as it only previously applied to existing super funds.

## Commissioner discretion on excess contributions tax

The Government has proposed changing the legislation to allow the Commissioner of Taxation to exercise discretion for the purposes of excess contributions tax before an assessment is issued. Currently if a client exceeds their contribution cap, they must wait until they receive an excess contributions tax assessment notice before they can apply (using the approved form) to have some or all of the contributions disregarded or reallocated to another financial year.

The Commissioner may choose to exercise this discretion where the excess contributions have arisen due to special circumstances (ie those that are unusual, exceptional, abnormal or uncommon and where applying the law would result in an unjust, unfair or otherwise inappropriate outcome).

### *Comment:*

- This measure should provide advisers and clients with greater certainty about their position in relation to excess contributions. It will allow them to more proactively deal with situations where the caps have been exceeded due to special circumstances.

## Social security changes

### Greater accessibility to Special Disability Trusts

*Date of effect: 1 July 2010*

The eligibility criteria and allowable uses for Special Disability Trusts (SDTs) will be amended to make them more accessible and to increase uptake.

The definition of a beneficiary will be expanded to include people with a disability who can work up to seven hours per week (excluding work in an Australian Disability Enterprise). In addition, this measure will amend the allowable uses for the trust to incorporate all medical expenses, including membership costs of private health funds, maintenance expenses for SDT property and discretionary spending of up to \$10,000 per year.

Establishing an SDT enables parents and immediate family members to put money aside for the future care and accommodation needs of a family member with a severe disability. With SDTs, up to \$551,750 (indexed annually) and the family home can be kept in the trust without being counted as an asset under the pension means tests for the beneficiary of the trust. No income of, or distributions from, the SDT are assessable under the pension means test.

### *Comment:*

- These changes make SDTs more attractive and accessible to aged care clients, who can use them to reduce the accommodation bond/charge and the daily income tested fee.

## **Disability support pension assessments**

*Date of effect: From 1 July 2010*

Assessments will be improved for disadvantaged job seekers and Disability Support Pension (DSP) claimants who are currently required to undergo a Job Capacity Assessment to ensure appropriate employment and income support is provided, as follows:

- From **1 July 2010**, job seekers who want a temporary exemption from participation requirements due to a medical condition will no longer require a Job Capacity Assessment. Exemption determinations will be made by Centrelink staff.
- From **1 July 2011**, job seekers who need to have their work capacity assessed will undergo a revised and more efficient assessment of their need for employment services, which will be conducted by an allied health professional.
- From **1 January 2012**, DSP claimants without sufficient evidence of a future work capacity of less than 15 hours per week may be referred to an alternative income support payment and offered employment assistance through Job Services Australia, or Disability Employment Services. These services will assist in developing the skills of job seekers or building evidence of their future work capacity for subsequent claims, which may be made at any time.

## **More flexible FTB payment arrangements**

*Date of effect: To be determined*

It was proposed in the 2008 Budget that all Family Tax Benefit (FTB) recipients who had not lodged tax returns for more than 12 months and had not responded to Centrelink requests to do so, would no longer receive FTB payments until they lodged their tax returns. Lodgement of tax returns is necessary to reconcile a person's FTB entitlement based on their actual taxable income. This ensures people only receive their correct entitlements.

It's now proposed these arrangements will be retained in general, but that payments continue to be made in circumstances where:

- people don't have any FTB debt, or
- ceasing payments would cause undue hardship.

The measure doesn't impact whether a person accrues eligibility for FTB, only when it's paid.

## **Cessation of Family Day Care Start Up Payment**

*Date of effect: 1 July 2010*

The Family Day Care (FDC) Start Up Payment (\$1,500 per eligible service) and the Remote Area FDC Start Up Payment (\$5,000 per eligible service) will cease on 1 July 2010. These payments haven't been successful in encouraging potential carers to establish FDC services as ongoing businesses.

## **Paid Parental leave**

*Date of effect: 1 January 2011*

The Government's 18 week Paid Parental Leave Scheme, which is at the level of the national minimum wage, will be paid to eligible new mothers from 1 January 2011. Also, funding will be provided to Centrelink, the Fair Work Ombudsman and the Social Security Appeals Tribunal to ensure employers meet their obligations and are able to seek a review of a decision that they must pay parental leave to an employee.

## **Protection for accommodation bonds**

*Date of effect: 1 July 2011*

The Government will provide enhanced protection for accommodation bonds held by aged care providers by applying more stringent requirements on how they can be invested. In addition, criminal penalties for misuse of accommodation bonds will be introduced and reporting requirements will be strengthened.

## One stop aged care shops

*Date of effect: 1 July 2010*

One-stop shops will be established across the country with integrated systems to enable older Australians and their families to more easily access information and assessments for aged care services.

## Youth Allowance enhancements

*Date of effect: To be determined*

Funding has been confirmed to implement reforms to student income support announced in the 2009 Budget. These include changes to the criteria for independence and the personal income test and will provide greater access to the Youth Allowance for people from lower income backgrounds.

## Outstanding Centrelink debts

*Date of effect: 1 July 2010*

The current process will be improved for garnishing the returns of ex-Centrelink customers who have an outstanding debt and no arrangement in place to repay the amount. This will be done by enabling the ATO to automatically intercept tax refunds on behalf of Centrelink.

## War widow(er) pensions

*Date of effect: 1 July 2010*

Eligibility for the war widow(ers) pension will be removed for people who, before applying for the pension, enter a de facto relationship following the death of their veteran partner. This measure will remove an anomaly which currently exists under the Veteran's Entitlement Act 1986, that allows widow(ers) who have entered a de facto relationship following the death of the veteran partner to claim war widow(ers) pension entitlements, while those who have married cannot.

## References

11 May 2010, [Budget Papers](#)

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