Steady the Ship…Manage the Deficit

When Treasurer Wayne Swan delivered his fourth Budget - and Julia Gillard's first as Prime Minister of Australia – it was designed to deliver "the best combination of hard work, responsible budgeting, and well considered policies to the difficult challenges ahead". Mr Swan emphasised a focus on jobs, as well as on infrastructure spending, education spending, hospital and health care spending, but has also identified $22 billion worth of savings over the forward estimates period (i.e. until 2014-15), two-thirds of which will come from Government spending reductions. The Government estimates that these Budget measures should see a return to a Budget surplus of $3.5 billion in 2012-13.

So, let's highlight some of the key aspects of the Budget announcement and look at some of the salient proposals that may impact our readers, some of which should promote a discussion with your most trusted advisers.

Business Reform Package

The Government will abolish the Entrepreneurs' Tax Offset with effect from 2012-13, estimated to have an ongoing revenue gain of $365 million over the forward estimates period. However, small business will benefit from a new instant write-off for the first $5,000 of a motor vehicle purchased from the 2012-13 financial year. The remaining cost is then depreciated at 30 per cent (15 per cent in the purchase year), which was the previous treatment for the entire cost of the motor vehicle.

Proposed measures to allow small businesses to instantly write-off all assets costing less than $5,000 from the 2012-13 financial year as well as a reduction in the company tax rate to 29 per cent in the 2012-13 financial year are designed to enable more small businesses to prosper. The Government will also reduce the GDP adjustment factor for Pay As You Go (PAYG) instalment taxpayers from 8 per cent to 4 per cent for the 2011-12 financial year. The GDP adjustment method is used by the majority of taxpayers (mainly small businesses) required to pay quarterly income tax instalments, however also applies to individual investors, Trustees and superannuation funds.

Also, Company Directors should also be aware that the director penalty regime will be extended to superannuation guarantee amounts, making directors personally liable for their company's failure to pay employee superannuation.

Building Australia's Future Workforce Measures

The dependent spouse tax offset for taxpayers with a dependent spouse (i.e. non-working spouse) born on or after 1 July 1971 will phase out, which has been designed to reduce disincentives to work. From 1 July 2011 the Government will also increase the low income tax offset that is delivered to income earners who currently earn less than $67,500 through their regular employment salary during the year from 50 per cent to 70 per cent of their total entitlements designed to deliver up to $300 in more timely tax relief to income earners in the workforce.

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Motor Vehicle Fringe Benefits Tax Reforms

The Government will reform the current "statutory formula" method for determining the taxable value of motor vehicle fringe benefits by replacing the current statutory rates with a single rate of 20 per cent that applies regardless of the distance travelled. This reform, which will apply to new contracts entered into after 7.30pm on 10 May 2011 and phased over four years, has been designed to remove the incentive for people to drive their car further in order to obtain a larger tax concession, and "in the process burn more fuel" (Budget Overview, 2011-12).

Natural Disaster Recovery and Rebuilding Assistance

The Government has made the Disaster Income Recovery Subsidy payments for the recent floods in Australia and for Cyclone Yasi exempt from income tax, and likewise the Government will provide an income tax exemption for certain clean up and recovery grants paid to small businesses and primary producers under the Natural Disaster Relief and Recovery Arrangements.

However, to assist in the rebuilding of flood and cyclone affected regions, the Government will introduce a temporary flood and cyclone reconstruction levy for the 2011-12 financial year (only). This will apply to taxpayers with taxable income of between $50,001 and $100,000 at a rate of 0.5 per cent of their taxable income, and 1.0 per cent on taxable income above $100,001.

Non-Profit Sector Reforms

The Government intends to reform the tax concessions provided to non-profit entities to ensure that they are targeted only at those activities that directly further a non-profit entities altruistic purposes. So, from 10 May 2011 non-profit entities will pay income tax on profits from any new unrelated commercial activities (i.e. those earnings they retain in their commercial undertakings).

Personal Income Tax Reforms

In a measure designed to discourage income splitting between adults and children, the Government will remove the ability of minors (i.e. children under the age of 18) to access the low income tax offset, thereby reducing the tax payable on their unearned income, such as dividends, interest, rent, royalties and other income from property, with effect from 1 July 2011.

Reduced Relief on Account Based Pension Minimums

The drawdown relief that has been provided over the last three financial years will be phased out by the end of the 2011-12 financial year. Minimum payment amounts for account-based, allocated and market-linked (term allocated) pensions will be reduced by 25 per cent (and not 50 per cent) for the 2011-12 financial year and will return to the normal aged based/ percentage based factors in 2012-13.

Superannuation Reforms

The Government will provide eligible individuals with the option to have excess concessional contributions (i.e. those contributions which breach the relevant cap for the first time) by $10,000 or less, refunded by their superannuation fund and taxed at their potentially lower marginal tax rate rather than applying the 46.5 per cent effective excess contributions tax rate. This measure will not provide any respite for the 13,000 of the total 95,000 Self Managed Superannuation Fund (SMSF) members who have exceeded their cap since the reduced caps came into force on 1 July 2007.

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All SMSF members will also see a 20% increase in the Australian Taxation Offices annual supervisory levy from $150.00 to $180.00 for the 2010-11 financial year.

As expected the Government will also set a higher concessional contribution cap for eligible individuals aged 50 and over from 1 July 2012 with total superannuation fund balances of less than $500,000, to $25,000 above the general concessional cap. It should be noted however, that further information needs to be provided in regards to this reform measure, as there is no mention of whether this measure will apply to only those individuals in the accumulation phase of superannuation, and restrict those who have commenced an income stream/account based pension or withdrawn monies from superannuation in the past.

Reduction in Higher Education Contribution Scheme Discounts

From 1 January 2012, the Government will reduce the discount available to eligible Higher Education Contribution Scheme (HECS) students electing to pay their student contribution up-front from the 20 per cent to 10 per cent, as well as reduce the bonus on voluntary payments to the Australian Taxation Office of $500 or more from 10 per cent to 5 per cent.

So how will the Budget measures impact our Economy and that of investors?

For those who viewed Lachlan Partners' Chief Investment Officer, Paul Saliba on the Sky News Budget 2011 The Bottom Line, our views are that the Federal Budget reform measures are generally in line with our expectations and should not see any significant change to the Reserve Bank of Australia's (RBA's) course on monetary policy. It is important that the Government continues to keep our economy moving towards a Budget surplus, however we believe that we do not need to push too quickly towards that goal. Instead, we need our Government to apply the right mix of spending restraint and measures to support growth.

The $36.2 billion investment in infrastructure (i.e. roads, rail and ports) until 2014-15 will certainly increase spending in some of the weaker parts of the Australian economy, but should not adversely impact our resource sector too greatly. In fact it is the increased export volumes and high commodity prices of the resources sector that have lead to a strong outlook for the Australian economy, with the sector planning to invest $76 billion in 2011-12 according to Mr Swan. As such we believe that measures put forward in the Federal Budget delivered a responsible, if not tough, agenda, and one which will keep the traditional Labor supporters on side.

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