

Federal Budget measures – May 2002

The real significance of the 2002 budget from a taxation perspective lies in the Government's disclosure that it is peering hard into the future through its generational report to work out what retirement incomes will be like in the next forty years. It will come as no surprise to learn that it finds the outlook bleak. The population is aging and fertility rates are falling. Savings have all but disappeared. The numbers on aged welfare will grow. Something will have to change or the few left willing and able to work will not be able to pay for those who can't. The 2002 Budget changes are only minor, a mere tinker, but on balance, they do make superannuation that bit more attractive for most clients.

a) Member's choice of funds – Member's choice of funds was announced years ago. The legislation is drafted but has been stalled in the Senate for a few years. The Government remains enthusiastic and has now announced that money will be spent educating everyone about its merits.

b) The superannuation surcharge rate - In line with an election promise, from 1 July 2002, the superannuation surcharge rate falls by 10% from its current level of 15% over each of the next three years. This means that the maximum surcharge rates will be reduced to 13.5% in 2003, 12% 2004 and 10.5% in 2005 and thereafter. The Government will then consider the situation afresh. This is a step in the right direction, particularly for high-income employees. But most business clients easily sidestep the surcharge by superannuating their spouses or by tax planning their income below the surcharge threshold (currently \$85,242). Surcharge of 10.5% is still a pretty big hit, so expect the sidestepping to continue well after 2005.

c) Deductions for self-employed persons - The threshold for full deductibility of contributions for self-employed persons has been lifted from \$3,000 pa to \$5,000 pa, with the excess remaining 75% deductible. The maximum deductible amount remains equal to the person's age based deduction limit. This means a self-employed person contributing say, \$10,000 a year will be about \$250 a year better off from 1 July 2002. Whilst nice, this is not significant and one expects self-employed persons who are really interested in superannuation will continue to incorporate and superannuate themselves and their spouses as employees.

d) Continuing contributions to age 75 - At present those over 70 cannot contribute to a fund, (although a fund can accept some mandated employer contributions in limited circumstances). From 1 July 2002, those aged over 70 but less than 75 will be able to make personal contributions to superannuation provided they are working at least ten hours a week. This is consistent with the current treatment of people aged over 65 but less than 70.

The Superannuation Guarantee arrangements will not apply to those working past age 70. Individuals aged over 70 but less than 75, whom are making personal superannuation contributions, will not be eligible for an income tax deduction or the co-contribution. The contributions will not be deductible for either the member or an employer unless they are mandated employer contributions made under an industrial award obligation. The Government will change the rules for accessing superannuation benefits so members aged over 70 but less than 75 will not need to pay a lump sum or start a pension unless they cease to work 10 or more hours per week. Interestingly, "working" includes time spent investing, and therefore many older members pass the 10 hours test even if they have ceased their usual employment.

e) Quarterly Superannuation Guarantee contributions - From 1 July 2003, employers must pay Superannuation Guarantee (SG) contributions to a complying superannuation fund or retirement savings account for eligible employees on at least a quarterly basis. At present, employers are only required to make these contributions on an annual basis, although most employers choose to contribute more frequently than this.

f) The following consequential changes were also announced: for defaulting employers, the Superannuation Guarantee Charge (SGC) will be imposed quarterly with a lower administration component; any penalty interest will be calculated from the first day of the relevant quarter; the earnings threshold will change from \$450 per month to \$1,350 per quarter; employers must report to their employees the amount and destination of SG contributions when contributions are made; and no administration or interest penalties will apply to shortfalls in the first two quarters from 1 July 2003.

g) Sharing spouse contributions - From 1 July 2003 spouses can share contributions to accumulation funds. This means that many members can double their tax-free threshold on lump sum benefits paid after age 55 to about \$200,000, and double their reasonable benefit limits to about \$1,000,000 for lump sums and about \$2,000,000 for pensions. This is a significant benefit that will see additional tax benefits for many people, particularly high income employees who cannot superannuate their spouses through a business but can afford to put such large amounts into superannuation. Sharing does not extend to existing benefits. Often, spouses will as far as possible equalize their superannuation contributions before starting allocated pensions and it seems that this will continue for some years yet, since it will take quite a while for these new rules to have an impact.

h) Reducing the tax rate on excessive Eligible Termination Payments (“ETPs”) - ETPs that exceed a member’s Reasonable Benefit Limit (“RBL”) are currently taxed at 47% plus Medicare even where the underlying contributions and investment income have previously been taxed at 15% (and in some cases the contributions have been subjected to the 15% surcharge). From 1 July 2002, the tax treatment of an ETP from a superannuation fund that exceeds a taxpayer’s Reasonable Benefits Limit will be modified to limit the effective tax rate on the payment to no more than 47% plus Medicare. The rules for excess pension benefits have not changed.

i) Temporary residents to access their superannuation when departing Australia - From 1 July 2002, temporary residents may access their benefits on leaving Australia permanently. Benefits paid from a taxed source will be taxed at 30 per cent and benefits paid from an untaxed source will be taxed at 40 per cent. These amounts will be payable by the fund and will be withheld from amounts paid to the member. The member’s undeducted contributions will not be taxed. The measure will not apply to Australian citizens, permanent residents or other individuals who can retire in Australia and receive the age pension.

j) Government contributions announced - From 1 July 2002 the Government will pay up to \$1,000 to match the member’s own contributions. The \$1,000 maximum applies if the member’s income is \$20,000 pa or less. Phase out rules apply up to \$32,000 pa. At first blush this seems relevant to business clients whose spouses only work part time. But the contributions are not deductible, so there is little difference between this and an extra deductible contribution for the client. But it could be relevant to other clients who are only employed part time, assuming they can afford to pay \$1,000 to a fund. At present, low-income earners receive a maximum rebate of \$100 for personal undeducted contributions. This rebate will cease on 30 June 2002.

k) Kids’ contributions announced - There is some good news if you love your kids. From 1 July 2002 you can contribute up to \$3,000 per child per three-year period to a child’s super account. The contributions will be “undeducted contributions” i.e., there will be no tax relief for these contributions but they will not be taxed in the fund’s hands. Neither will they qualify for the government’s low-income earners’ co-contribution strategy.

Other key budget announcements include: economic growth to increase by 3.75%, with unemployment rising to 6% and inflation of 2.75% for the financial year; prescriptions to rise by \$6.20 to \$28.60 (Concession Holders to pay \$4.60 a rise of \$1.00); no new taxes to be introduced; the introduction of a baby bonus for first time mothers to receive a refund of some taxation paid whilst working; and the balance of Telstra to be sold in 3 parcels throughout 2003-2004.