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2009 Personal Finance Budget Summary

The budget has provided a number of significant financial planning changes which have been outlined in this summary. Some readers will not be interested in all of the details so I start with a brief summary of the major changes introduced:

- Reduction of Tax Deductible Contributions to Superannuation from $50,000 to $25,000 for those under 50 years old and from $100,000 to $50,000 for those aged 50 and older. Effective July 1st 2009.

- Reduction of the Superannuation Co-contribution to $1 per $1 of eligible personal contributions up to a maximum of $1,000. Effective 1st July 2009 until 30th June 2012 (3 years) and then increasing to $1.25 per $1 of eligible personal contributions up to a maximum of $1,250.

- Continuation of the 2008-09 drawdown relief for superannuation pensions through 2009-10 reducing the minimum draw down rates by 50%.

- Single Age Pension rate to increase by $32.49 per week with the Combined Couple Age Pension rate to increase by $10.14 per week.

- Increase in the Age Pension income test taper from 40 to 50 cents in the dollar for a single pensioner and 20 to 25 cents in the dollar for each member of a couple.

- No new entrants to the Pension Bonus Scheme from the 20th of September 2009. Replaced in some way by the Work Bonus for pensioners which will leave exempt from the Income Test half of the first $500 of fortnightly income.

- Qualifying age for Age Pension to increase to 67 by 2023.

- Increase in the Senior Concession allowance for singles by $129 per annum.

- Introduction of a new carer's supplement, $600 per annum to all Carer Allowance recipients for each person being cared for, $600 per annum to all Carer Payment recipients.

- Commonwealth Senior's Health Card income test will not be amended to include gross tax-free superannuation pension income however it will include income which has been salary sacrificed to superannuation.

- First Home Owners Boost to continue as is until the 30th September and then be wound back by $3,500 for existing home purchases and $7,000 for building a new home up until the 31st December 2009.

- Introduction of paid parental leave for up to 18 weeks at the Federal Minimum Wage – currently $543.78 per week.

- Introduction of new Private Health Insurance Incentive Tiers with existing arrangements remaining unchanged for singles earning less than $75,000 and families earning less than $150,000 per year.

- Increase in the Small Business Tax Break from 30% to 50% of eligible purchases from 13th December 2008 to 31st December 2009 as long as the equipment is installed by 31st December 2010.

- Previously announced income tax cuts left untouched.

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

I conclude the summary by addressing two specific issues:

- Transition to Retirement Income Stream Strategies
- Whether superannuation has now been made 'worse off'?

Reduction of Tax Deductible Contributions to Superannuation

From 1 July 2009, the maximum tax deductible contribution to superannuation is $25,000 a year for people under the age of 50, and $50,000 a year for those over the age of 50 up to the 2011/12 financial year. (These people previously were allowed to make $100,000 tax deductible contributions).

For an employed person tax deductible contributions include the compulsory employer contributions that they receive (these are tax deductible to the employer) and any salary sacrifice contributions.

For a self employed person, tax deductible contributions refer to the contributions that they make and then claim a tax deduction for.

This limit to the amount of tax deductible contributions is a significant change, and the most rigorous limitations that have applied to tax deductible contributions since the era of compulsory superannuation.

So what does this mean in terms of personal finance strategy?

Superannuation remains the most tax effective investment environment available to most Australians. People can direct contributions into superannuation at a tax rate of 15% (a saving of up to 31.5% compared to income tax rates), can have the investment earnings taxed at a maximum of 15% (again a saving of up to 31.5% compared to income tax rates) and can withdraw from superannuation tax free in retirement.

This change reduces the ability of people to make large, tax advantaged superannuation contributions close to retirement.

My initial thought is that this will see people put a greater emphasis on making superannuation contributions early in life. It is worth keeping in mind, however, that compulsory superannuation is not yet 20 years old – and we are naturally seeing people with ever increasing superannuation

<u>Strategy Thoughts</u>
In this current financial year, the last with the higher maximum superannuation contributions, people may wish to increase their superannuation salary sacrifice or self employed superannuation contributions as much as they can over the last 2 months leading up to June 30.

For example, a person earning $100,000 a year might be receiving compulsory 9% superannuation contributions ($9,000) while making a further salary sacrifice contribution of $25,000 a year. From 1 July they will be limited to the $9,000 employer contributions and $16,000 in salary sacrifice contributions. So, over the last 2 months of this year they might salary sacrifice as much of their income as they can – even more than they are doing now - before the July 1 restriction comes into place.

Reductions in Government Superannuation Co Contributions

From the 1st of July 2009 the Government Co-contribution will be reduced. Currently, if you are earning less than $60,342 a year you can make a personal contribution to superannuation and receive a Government Co-contribution of $1.50 for every $1.00 that you contribution up to a limit, depending on your income. The maximum Government Co Contribution is $1,500 when you make a personal contribution of $1,000 if you are earning less than $30,342.

From the 1st of July the government will only contribute $1.00 for every eligible $1.00 personal contribution. This will increase to $1.25 from July 2012.

Strategy Thoughts

The period leading up to the 1st of July is the most powerful time to make a Government Co-contribution, when the Government contributes $1.50 for every $1.00 that is made as a personal contribution. It is an opportunity that people might pay particular attention to – including the possibility of making contributions on behalf of adult children or grandchildren. Keep in mind that you don't have to make a $1,000 contribution – if you put in a smaller amount like $50 it will be matched with a $75 contribution. This is still the most efficient way of turning $50 into $125 that I know of.

Lower Minimum Superannuation Pension Drawdowns

It was announced that halving the minimum draw down rate from a superannuation pension for the next financial year – similar to what has been put in place for the current financial year. This effectively gives people more choice if they wish to draw less from their superannuation pension, giving their investments more time to recover.

Strategy Thoughts

Some people have both an account based pension and a 'term allocated pension'. The term allocated pension generally provides people with some Centrelink advantages, with only half of the assets of the term allocated pension counted for the Centrelink assets test. Given the additional Centrelink benefits in a term allocation pension, it would make sense that people halve the withdrawal from this income stream to preserve its value prior to reducing the withdrawals from their account based pension.

Age Pension Payment Rates

An additional $1,689 a year will be paid to full rate single pensioners and $527 a year to full rate pensioner couples (combined). This brings the total value of pension payments for singles to two-thirds (66%) of the couple combined package.

From 20 September 2009 under the new arrangements, full rate single pensioners will receive an additional $32.49 per week through: an extra $30.00 per week in the base pension and an extra $2.49 per week in a new fortnightly Pension Supplement. Full rate pensioner couples will receive an additional $10.14 per week in the new fortnightly Pension Supplement.

From 20 September 2009, the existing Goods and Services Tax Supplement, Pharmaceutical Allowance, Utilities Allowance, Telephone Allowance (at the higher internet rate), and increased assistance of $2.49 per week for singles and $10.14 per week for couples combined will be included in the new fortnightly Pension Supplement.

The Government will also develop a new price index, to apply from 20 September 2009, designed specifically for households who rely on the pension. The Government will use this new measure of price changes, the Pensioner and Beneficiary Living Cost Index, to index base pension rates where it is higher than the CPI. The CPI will still be used to index relevant eligibility thresholds.

Currently, the single rate of pension is benchmarked to 25 per cent of Male Total Average Weekly Earnings (MTAWE). That is, the pension is set at this level if CPI indexation happens to produce a lower pension rate. Under the new arrangements, not only will the pension be increased by the higher of the CPI or the new Pensioner and Beneficiary Living Cost Index, but the effective benchmark for the single pension will also be increased from 25 per cent to 27.7 per cent of MTAWE.

The pension income test will be changed. The rate at which the pension is withdrawn for each dollar of additional private income will be increased from 40 cents to 50 cents for income above the free area (currently $138 per fortnight for singles and $240 per fortnight for couples).

Pension Bonus Scheme to be closed

The Pension Bonus Scheme will be closed to new entrants from 20 September 2009. Existing members of the scheme will continue to accrue entitlements under existing rules.

Strategy Thoughts

If turning Age Pension age before the 20th September it would be worth checking whether the Pension Bonus Scheme is of benefit.

Work Bonus Scheme for pensioners

Under the new Work Bonus, 50% of the first $500 per fortnight of employment income will not count for income test purposes.

Qualifying age for Age Pension to increase to 67 by 2023

The qualifying age for the Age Pension and the Commonwealth Seniors Health Card for men and women will be increased to 67 years of age from 2023. The transition to the higher Age Pension age will commence in July 2017, with the qualifying age increasing by six months every two years, to reach 67 on 1 July 2023.

Senior Concession Allowance Increase for Singles

A new Seniors Supplement will be established for Commonwealth Seniors Health Card holders. The Seniors Concession Allowance and the Telephone Allowance will be consolidated into the new Seniors Supplement. The single rate of the Seniors Supplement will include an extra $129 a year, to bring it to two thirds of the rate paid to couples combined.

Carer's Supplement

The new supplement will be ongoing and non-taxable. The first payment will be made by 30 June 2009 with subsequent payments starting from 1 July 2010. The new supplement will provide:

- $600 per annum to all Carer Allowance recipients for each person being cared for; and
- $600 per annum to all Carer Payment recipients.

People who receive both Carer Payment and Carer Allowance will be eligible for both payments. The existing Child Disability Assistance Payment of $1,000 per annum for carers who are paid Carer Allowance (child) will continue.

Commonwealth Senior's Health Card - Income Test Amendment

The Commonwealth Senior's Health Card income test will now include which has been salary sacrificed to superannuation but not gross tax-free income from superannuation income streams as had been previously announced. This is good news for those who were concerned that their tax free superannuation pension incomes may have impeded future access to the benefits provided by holding this card.

First Home Owners Scheme

For eligible first home buyers entering into contracts between 1 July 2009 and 30 September 2009 (inclusive) the First Home Owners Boost will continue to provide $7,000 for the purchase of established homes and $14,000 for the purchase of new homes. In combination with the existing $7,000 First Home Owners Scheme grant, this means that first home owners will receive a total of $14,000 for established homes and $21,000 for new homes.

For eligible first home buyers entering into contracts between 1 October 2009 and 31 December 2009 (inclusive) the First Home Owners Boost will provide $3,500 for the purchase of established homes and $7,000 for the purchase of new homes. When combined with the existing First Home Owners Scheme grant, this means that first home owners will receive a total of $10,500 for established homes and $14,000 for new homes.

Paid Parental Leave

The Government will introduce a Paid Parental Leave scheme from 1 January 2011. The scheme will provide eligible parents with up to 18 weeks of leave at the Federal Minimum Wage, currently $543.78 per week. These payments will be treated as taxable income and will affect entitlement to family assistance payments, but will not be counted as income for income support payments. People who elect not to receive Paid Parental Leave or who do not qualify will continue to receive the Baby Bonus and other family payments, where they meet eligibility requirements.

Primary carers will be eligible for the scheme if they:

- earned less than $150,000 in the full financial year prior to the birth or adoption of a child;
- have worked at least 330 hours over the 10 months preceding the birth or adoption of a child; and
- have also worked continuously with one or more employers for at least 10 of the 13 months before the expected date of birth or adoption.

Parents who choose to receive Paid Parental Leave will not receive the Baby Bonus, except in cases of multiple births where parents will not receive the Baby Bonus for the first child only. Parents who choose to receive Paid Parental Leave will also not be eligible for the Family Tax Benefit Part B and the dependent spouse, child-housekeeper and housekeeper tax offsets for the 18 week period or whilst they are in receipt of Paid Parental Leave.

Private Health Insurance Incentive Tiers

Effective 1 July 2010, the Government will introduce three new 'Private Health Insurance Incentive Tiers'. Existing arrangements will remain unchanged for singles with income of less than $75,000 per annum and families with incomes of less than $150,000 per annum.

- Tier 1 will apply to singles with income of more than $75,000 (more than $150,000 for families), based on current projections. The private health insurance rebate will be 20%, increasing to 25% at 65 years of age, and to 30% at 70 years. The private health insurance surcharge for not taking out complying private health insurance will remain at 1%.

- Tier 2 will apply to singles with income of more than $90,000 (more than $180,000 for families). The private health insurance rebate will be 10%, increasing to 15% at 65 years of age, and to 20% at 70 years. The surcharge for not taking out complying private health insurance will be increased to 1.25%.

- Tier 3 will apply to singles with income of more than $120,000 (more than $240,000 for families). No private health insurance rebate will be provided. The surcharge for not taking out complying private health insurance will be increased to 1.5 per cent.

Increase in the Small Business Tax Break

The Government will expand the Small Business and General Business Tax Break announced in the *February 2009 Updated Economic and Fiscal Outlook* to provide additional assistance to small businesses. A bonus deduction of 50% will be available to small businesses that acquire an eligible asset between 13 December 2008 and 31 December 2009 and install it ready for use by 31 December 2010. The previously announced 30% and 10% bonuses will continue to apply to all other businesses.

Income Tax - Cuts Untouched

The government have left unchanged the promised income tax changes for the next two financial years including increases in the Low Income Tax Offset

Current			**From 1 July 2009**			**From 1 July 2010**	
Taxable income ($)	Rate (%)		Taxable income ($)	Rate (%)		Taxable income ($)	Rate (%)
0 - 6000	0		0 - 6000	0		0 - 6000	0
6,001 - 34,000	15		6,001 - **35,0000**	15		6,001 - **37,000**	15
34,001 – 80,000	30		**35,001** - 80,000	30		**37,001**- 80,000	30
80,001 - 180,000	40		80,001-180,000	**38**		80,001-180,000	**37**
180,001 +	45		180,001 +	45		180,001 +	45
Low Income Tax Offset (LITO)	$1,200			1350			1500
LITO Maximum Threshold	$60,000			$63,750			$67,500
Effective tax free threshold (incomes less than $30,000)	$14,000			$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	2009/10	2010/11
$30,000	$2,400	$2,250	$2,100
$40,000	$5,200	$4,900	$4,450
$50,000	$8,600	$8,300	$7,850
$60,000	$12,000	$11,700	$11,250
$70,000	$15,000	$14,850	$14,550
$80,000	$18,000	$17,850	$17,550
$90,000	$22,000	$21,650	$21,250
$100,000	$26,000	$25,450	$24,950
$110,000	$30,000	$29,250	$28,650
$120,000	$34,000	$33,050	$32,350
$130,000	$38,000	$36,850	$36,050
$140,000	$42,000	$40,650	$39,750
$150,000	$46,000	$44,450	$43,450
$160,000	$50,000	$48,250	$47,150
$170,000	$54,000	$52,050	$50,850
$180,000	$58,000	$55,850	$54,550

Transition to Retirement Income Stream Strategies

There was some discussion that the transition to retirement rules may be under some threat. This has proven to be unfounded. A transition to retirement strategy remains one of the most effective ways to increase the tax effectiveness of a person's situation in the lead up to retirement.

Of course, one element of the strategy, the ability to increase tax advantaged salary sacrifice contributions back into super, may be hampered by the new limits on tax deductible contributions into super mentioned earlier.

The Philosophical Question – Has Superannuation Ever Been Made 'Worse Off'?

One comment that I have always felt that I have been able to make to people who are cynical about the superannuation system, and the seemingly ongoing rule changes, is that a successful superannuation system is in the best interest of any government – because it reduces the need for government Age Pension payments. I have then been able to point out that the history of superannuation changes has '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

While this budget puts greater restrictions on superannuation contributions than had been in place previously, I can't see that it actually makes anything 'worse off' for superannuation investors. Rumours that I heard prior to the budget included that retirement income streams would go back to being taxed and that transition to retirement arrangements would be wound back. These have not eventuated.

This document has been prepared as a brief summary of the 2009 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.