PROFILE
FINANCIAL SERVICES

FEDERAL BUDGET ANALYSIS MAY 2012

May 2012 Federal Budget

The Australian government unveiled its annual budget yesterday evening, on Tuesday 8 May 2012. In this analysis we have focused on budget announcements that may affect your financial planning strategy or investments. It is important to bear in mind that these announcements have not yet been legislated. In addition, the information in this update is general – please contact us if you would like to discuss your specific situation in more detail.

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1 ECONOMY AND MARKETS

1.1 Summary

This budget was delivered in line with what you would expect from a political party campaigning for re-election in the face of a continuing global sovereign debt crisis - **"We are returning to surplus while ensuring families and small businesses are sharing in the benefits of the resources boom".**

Markets were not too surprised by this budget, with most key measures having been previously leaked. Several economists have somewhat softer targets than the Treasury's for 2012/13, and that - together with political uncertainty - will add to the difficulty of achieving a surplus in the year ahead.

The underlying cash deficit for 2011/12 is estimated at $44.0bn (3.0% of GDP). In accrual terms, the fiscal surplus for 2012/13 is estimated to be $2.5bn (or 0.2% of GDP). The Budget then moves into a marginal cash surplus of $1.5bn in 2012/13 and $2.0bn in 2013/14.

Key treasury forecasts

FINANCIAL YEAR	REAL GDP %	INFLATION % (CPI)	UNEMPLOYMENT RATE %	FISCAL POSITION (DEFICIT / SURPLUS)	
				A$ BN	% OF GDP
2011/12 (e)	3.00	1.25	5.25	-42.0	-2.8
NEXT YEAR (e)	3.25	3.25	5.50	+2.5	+0.2
2013/14 (e)	3.00	2.50	5.50	+2.6	+0.2
2014/15 (p)	3.00	2.50	5.00	+7.0	+0.4
2015/16 (p)	3.00	2.50	5.00	+9.5	+0.5

1.2 Breakdown

Key measures (over 4 years)

SPENDING	$ BILLION
HEALTH AND AGED CARE	2.217
TRANSPORT	2.700
SMALL BUSINESSES	0.714
DEFENCE	1.100
FAMILIES	0.426

SAVINGS	$ BILLION
TAX CUTS NOT PROCEEDING	7.824
DEFENCE	5.400
SUPERANNUATION CONCESSIONS	2.447
LIVING AWAY FROM HOME	1.000
TRANSPORT CHARGES	1.300
OVERSEAS AID TARGET DEFERRED	2.900
DIVIDENDS	0.400

1.3 Impacts on the economy

The Treasurer has put great emphasis on the importance of returning to surplus – and (on the Budget forecasts) a peaking of net debt at 9% of GDP in 2012/13. Most importantly this highlights that the Australian fiscal position is still significantly better than most other developed economies.

While difficult to estimate exactly, economic strategists' consensus is that the current fiscal policy is now set to detract at least 1% from growth in 2012/13. This is particularly troubling at a time of further evidence of weakening in demand and soft exports!

The Government's economic outlook appears broadly plausible according to most economists, although slightly more optimistic than the RBA forecasts. The Government expects GDP growth of 3.25% in 2012/13 and unemployment to rise to around 5.50% (currently 5.20%) in 2013. Furthermore, they expect underlying inflation to remain well within the RBA's 2-3% target band over the forecast horizon.

That being said, given the softness in current labour market conditions and the significant degree of tightening implied by the Budget, monetary policy may well need to become more accommodative over coming months and most forecasters now expect further interest rate cuts by the RBA.

1.4 Impacts on investors

The market reaction to the Budget was muted - most of the key announcements had been released during the day and so there were no big surprises when it finally came to announcement time last night. The Australian dollar and Australian share market futures were slightly lower, but the weak start to European markets was the more likely driver behind these moves. Interest rate markets were also largely unchanged.

Looking to the future, investors must ask themselves several questions: Can the government in fact return to surplus in the face of lacklustre global economic growth, softer exports and domestic spending, and weaker terms of trade driven by falling commodity prices? And if they are so determined to achieve this result, how sensitive is the economy (primarily non-resources sector) to a fiscal contraction, and therefore at what cost to the Australian economy might this surplus come? Where the Budget is targeting savings in the corporate sector, what impact will this have on business sentiment and future hiring plans which feed directly into consumer confidence and spending? For how long can we continue to rely on revenue and capital expenditure flow-through from the booming commodities sector, if China is slowing down and shifting domestic policy from one that is commodity intensive, to domestic consumption driven? And finally, if Treasury has underestimated the impact of their fiscal stance on unemployment (15% of the Australian labour force is in the retail sector), what impact could it have on mortgage defaults and house prices?

1.5 Outlook

Although answers to the above questions remain open, we are becoming increasingly cautious and sceptical about the outlook for the Australian economy. Thankfully our central bank (RBA) has more flexibility than most global developed central banks and (as recently demonstrated) they are prepared to use their interest rate tools as required. A mortgage broker emailed Jai and a few others this morning informing us that we could now take out a mortgage on a variable rate structure at under 6%! This is an indication of giant silver lining. The housing market is the one place we have yet to suffer like other global developed economies have, and thankfully with limited oversupply in this market, we may muddle through.

We plan on sharing more in-depth views at our upcoming Budget seminar, but will leave it here by saying… we may be in the lucky country for now, but we as investors should not take that for granted.

2 TAX

2.1 Individuals

New personal tax rates (excluding the Medicare Levy)

Effective date: from 1 July 2012

In this budget, changes have been announced to personal tax rates to apply from 1 July 2012. They are intended to help offset increased costs from the carbon tax for lower income earners:

TAXABLE INCOME RANGE	TAX PAYABLE IN 2012/13
$0 – $18,200	Nil
$18,201 – $37,000	19% on amount over $18,200
$37,001 – $80,000	$3,572 + 32.5% on amount over $37,000
$80,001 – $180,000	$17,547 + 37% on amount over $80,000
$180,001 +	$54,550 + 45% on amount over $180,000

While the tax free threshold has been increased, marginal rates have also changed such that if you have a taxable income over $80,000 the changes will not have any benefit for you.

The effective tax free threshold will be $20,542 from 1 July 2012 (allowing for the low income tax offset – see below).

Low tax offset - reduced

Effective date: from 1 July 2012

The maximum low income tax offset is to be reduced from $1,500 to $445. It will be withdrawn at a rate of 1.5% on income over $37,000.

Medical expense tax offset

Effective date: from 1 July 2012

Previously, individuals with medical expenses exceeding $2,000 in a given year were able to claim a 20% rebate for the expenses over $2,000. The threshold will be increased to $5,000, the rebate reduced to 10% and a means test will apply. The means test will be based on the Medicare Levy Surcharge thresholds of $84,000 for a single person and $168,000 for couples/families.

If you are in a position to do so, you may wish to consider bringing forward (pre 30 June 2012) "optional" medical expenses.

Mature age worker tax offset to be phased out

Effective date: from 1 July 2012

The mature age worker tax offset will be phased out for workers born on or after 1 July 1957.

Low Income Medicare thresholds

Effective date: from 1 July 2011 (ie for the current financial year)

New thresholds have been announced for Medicare:

	NO MEDICARE IF TAXABLE INCOME IS EQUAL TO OR LESS THAN
Individuals	$19,404
Single pensioners under age pension age	$30,451
Couple (Combined)	$32,743
Additional for each dependent child/student	$3,007

Standard tax deduction proposal scrapped

The 2010 Federal Budget announced a standard deduction amount of $500, commencing 1 July 2012 and increasing to $1,000 in 2013.

However it looks like we will all need to continue to hold on to our receipts for work related expenses, as this proposed change has been abolished.

50% discount for interest income of up to $1,000 - scrapped

This is another policy from the 2010 budget that is not being implemented. For top marginal tax payers with at least $1,000 interest income, the net result will be the loss of a $225p.a tax saving that would have been available. For those in lower marginal tax brackets, or earning less interest income, the effect will be reduced.

Living away from home allowance

Effective date: from 7:30pm 8 May 2012, for all new arrangements. From 1 July 2014 for existing arrangements

This tax concession is being tightened up, so that it will only be available to employees who are genuinely maintaining a second home, and are living away from a home maintained in Australia. It is also being limited to a 12 month period (this will not impact "fly-in fly-out" tax concessions or the tax treatment of travel and meal allowances).

50% Capital Gains Tax discount for non-residents - removed

Effective date: from 7:30pm 8 May 2012

The 50% capital gains tax discount that currently applies on assets that have a connection with Australia (eg. property and business) will no longer apply for non-residents.

The discount accrued prior to this time may be able to have the discount applied, if a market valuation is obtained as at the 8th May 2012.

Personal tax rates for non-residents

Effective date: from 1 July 2012

New tax rates have been announced for non-residents:

TAXABLE INCOME RANGE	TAX PAYABLE IN 2012/13
$0 – $80,000	32.5% of each dollar
$80,001 – $180,000	$26,000 + 37% on amount over $80,000
$180,001 +	$63,000 + 45% on amount over $180,000

2.2 Business

While there are a couple of direct changes that may apply to companies (listed below) there may also be some flow on effects for companies, from the changes applying to individuals. With a tight employment market in many sectors, businesses that are employing high income earners, require some of their employees to be based overseas for an extended period, or employ non-residents, may face additional wages pressure.

30% Company tax rate to stay

The cut to company tax rates proposed in the 2010 Federal Budget is no longer going to be implemented. The company tax rate will stay at the existing rate of 30%.

There may be flow on effect to companies' forward plans and a reduction in capital investments, due to a decrease in projected after-tax profit.

Company loss carry back

Effective date: from 1 July 2012

Companies will be allowed to carry back tax losses of up to $1million, and receive a refund against tax previously paid. This could provide an annual cash benefit of up to $300,000. 2012/13 losses will be able to be carried back up to one year. From 2013/14 onwards, tax losses will be able to be carried back up to two years to offset the tax paid over that time.

The proposed changes are welcome news for SMEs that are subject to economic cycles (and other relatively short term challenges). They will also assist businesses that are facing longer term structural issues. This could allow businesses more time to address structural issues or delay winding up, which would support employment at least over the short term.

3 SUPERANNUATION

3.1 15% "surcharge" on concessional contributions for very high income earners

Date of effect: 1 July 2012

Individuals with income greater than $300,000 will be taxed at 30% on their superannuation contributions (up from 15%) The definition of "income" for this purpose will also be changed: "Income" will be taken to include taxable income, concessional superannuation contributions, adjusted fringe benefits, total net investment losses, target foreign income, and tax-free government pensions and benefits, less child support. For anyone receiving account-based pension income, that income will be either partially counted (for those less than 60) or exempt (for those over age 60).

The surcharge will only apply to the part of any contribution that takes the individual's income over the threshold. For example, suppose you have income excluding concessional contributions of $285,000. If you make a concessional contribution of $25,000 (taking your total income to $310,000), you would have the surcharge only applied to $10,000 of your super contributions.

Profile's view: While the proposal reduces the tax effectiveness of super for those in this income bracket, it still provides a favourable outcome versus paying the top marginal tax rate of 46.5%. Importantly, any earnings within superannuation for very high income earners will continue to be taxed at only 15%, and the tax exemption for assets supporting pension payments will be unaffected by the proposed change.

The challenge will be the administration of this proposal. The legacy of the "super surcharge" introduced on 20 August 1996 and abolished in May 2005 will be fresh in the minds of the Government and details are yet to be released as to how the new surcharge will be assessed and collected. The government will be keen to avoid the administrative nightmare the prior "super surcharge" created, thereby allowing the projected savings to be credited to the budget.

3.2 Increased concessional contributions cap for those over 50 deferred

Revised date of effect: 1 July 2014 (was 1 July 2012)

In the 2010/11 federal budget, the government announced that people aged 50 and over with less than $500,000 in super would be able to contribute an extra $25,000 in pre-tax (concessional) contributions each year from 1 July 2012. So the cap was effectively $50,000 pa for these individuals.

However, last night's budget deferred those measures until 1 July 2014. This means that for 2012/13 and 2013/14, all individuals will only be able to make concessional contributions of up to $25,000 per year. In 2014/15, the concessional cap is expected to increase to $30,000 through indexation, and the higher cap for over 50s would then commence at $55,000.

FINANICAL YEAR	2011/12	2012/13	2013/14	2014/15 (EXPECTED, BUT SUBJECT TO ACTUAL INDEXATION CHANGES)
Concessional cap – under 50	$25,000	$25,000	$25,000	$30,000
Concessional cap - 50 & over	$50,000	$25,000	$25,000	$55,000*

Note: * where the individual's super balance is less than $500,000

Profile's view: The government may well have deferred the implementation to "buy time" to administer what will be a difficult measure to implement. The benefit to the government is twofold – firstly it saves an estimated $1.46 billion, and secondly, it provides due time to implement an efficient system to administer the proposal.

- For over 50s: Most individuals over 50 should seriously consider maximising their concessional contributions to $50,000 in the current financial year, as the next 2 years now offer much less scope to top up superannuation.

  For those over 50 who are already maximising contributions, these will need to be reviewed and reduced to no more than $25,000 from 1 July 2012 to avoid getting caught by excess contributions tax. It's important to remember that super contributions includes the value of any insurance premiums paid in super.

  Individuals over 50 who have Transition to Retirement (TtR) strategies in place will need to review their draw-down rate from 1 July 2012, in light of the fact that their ability to contribute will be limited to $25,000 (previously $50,000).

- Anyone earning above $277,788 pa: Employers are only mandated to contribute 9% of incomes up to $175,820 pa, or $15,823.80 per quarter. However, some employees are fortunate to have their employers contribute 9% of their income even if it is greater than the threshold. Therefore, if an individual's income is greater than $277,778, they will breach the $25,000 concessional cap. Anyone in this situation should discuss alternate arrangements with their employer to minimise potential taxation liabilities.

3.3 Minimum pension draw down relief phased out

Date of effect: 1 July 2013

The minimum annual pension withdrawal required has been reduced in recent years as a result of the GFC and its impact on pension balances. This drawdown relief will be phased out, and returned to the normal rate from 1 July 2013 as per the table below.

AGE AT START OF PENSION (AND 1 JULY EACH YEAR)	IN 2011/12	IN 2012/13	2013/14 AND ON
Under 65	3%	3%	4%
65 – 74	3.75%	3.75%	5%
75 – 79	4.5%	4.5%	6%
80 – 84	5.25%	5.25%	7%
85 –89	6.75%	6.75%	9%
90 – 94	8.25%	8.25%	11%
95 +	10.5%	10.5%	14%

Profile's view: There has been conflicting commentary on this topic due to a change in the Regulations in recent months. In short, there will be no change to the current factors applied for account-based pensions.

3.4 Less favourable tax treatment of "golden handshakes"

Date of effect: 1 July 2012

The concessional tax rates on Eligible Termination Payments (ETPs) will only be available if an individual's total annual taxable income (including the ETP) is no more than $180,000. Amounts above this will be taxed at normal marginal rates.

Existing arrangements will be retained for certain ETPs relating to genuine redundancy, invalidity, compensation due to an employment-related dispute and death.

The ETP tax offset ensures that ETPs up to the ETP cap are taxed at a maximum tax rate of 15% for those over preservation age and 30% for those under preservation age.

This area has been under review for a number of years and follows the ending of the transitional arrangements on 30 June 2012, which included allowing qualifying ETPs to be transferred into superannuation. Therefore, from 1 July 2012, no ETPs can be rolled over to superannuation.

Profile's view: If you are expecting to receive an ETP in the near future, there could be advantages to receiving it in the current financial year if you are able to influence the timing of the payment.

3.5 Exemption of CGT for certain compensation payments and insurance policies

Date of effect:1 July 2005 (clarifies treatment of proceeds received since this date)

This budget included clarification that Capital Gains tax (CGT) will not apply to compensation, damages or certain insurance proceeds received indirectly through a trust. This ensures the same taxation outcome as payments received by an individual directly. Given that superannuation is a trust structure, it also ensures that super funds are not subject to CGT on insurance proceeds received.

Profile's view: This has been an area of concern given the ambiguous nature of the legislation. This provides welcome clarity around the treatment of insurance proceeds when policies are held in a trust structure such as superannuation.

3.6 Other measures announced or confirmed

- Superannuation Guarantee Contributions will be increased gradually, to be 12% from 1 July 2019:

FINANCIAL YEAR)	SGC
2011/12	9%
2012/13	9%
2013/14	9.25%
2014/15	9.5%
2015/16	10%
2016/17	10.5%
2017/18	11%
2018/19	11.5%
2019/20	12%

- The maximum age limit for superannuation contributions will be abolished, to support workers over 70 years old who remain in the workforce.
- Workers earning under $37,000 will pay no tax on their superannuation contributions from 1 July 2012.

4 SOCIAL SECURITY

4.1 School Kids Bonus

The School Kids Bonus replaces the Education Tax Refund that was put in place to help with children's education costs. The changes mean an increase to the maximum amount eligible families will receive (as previously only up to 50% of eligible expenses could be claimed). The payments will still be means tested.

Those eligible for the payment are families whose children are enrolled and attending school, and who are receiving Family Tax Benefit A (FTB A) (or other qualifying support payments or allowances that preclude the receipt of FTB A such as children receiving Youth Allowance).

The rates from 1 January 2013 will be:

- $410 for each primary school child
- $820 for each high school child

For those receiving the base rate of FTB A with two or more children, this will mean an extra $200 per year, or $100 a year for those with one child.

Payments will be paid automatically, twice a year in January and July. The Education Tax Refund will be paid in full for the 2011/12 financial year, to all eligible families, as a lump sum payment this June.

A key benefit of the changes - apart from more money in the family budget - is the ease of administration. Those qualifying will not need to keep receipts as proof of expenses, or wait until tax time to receive payments. However as this has not yet been legislated, we recommend you keep receipts until further notice!

4.2 Extra allowance for income support recipients

Those eligible for and receiving income support (eg recipients of Newstart, Sickness Allowance and Parenting Payments) will be paid an extra benefit of $210 each year for singles and $350 ($175 each) for couples per year, starting from 20 March 2013. The benefit will be paid in two instalments (March and September) each year. It will be tax-free, and indexed by CPI.

4.3 Liquid Assets Waiting Period (LAWP)

From 1 July 2013, the liquid assets test threshold will be doubled for those eligible to receive benefits:

- $5,000 for a single person with no dependents
- $10,000 for couples or singles with dependents

For those newly unemployed, the full waiting period of 13 weeks will not be imposed, allowing earlier access to income support. The level of assets before the full waiting period comes into effect [for Newstart] increases to $11,500 for singles and $23,000 for everyone else.

This means that those who are eligible for income support will be able to preserve cash reserves for a longer period of time while still receiving income support.

4.4 Aged Care

The Budget has a major focus on reforming the aged care system, due to the increasing portion of the population that is moving into this phase of life. The changes are designed to give people greater choice in services, whether they decide to stay at home or move into residential care.

The changes proposed to come into effect from 1 July 2014 include:

- The new income test for Home Care packages:

RECIPIENTS	INCOME-TESTED FEE*
Full Age Pension	No fee
Part pension	$0-$5,000
Self- funded retiree	$5,000 -$10,000

*indexed to CPI annually

Basic care fees of 17.5% of the basic age pension for Home Care recipients and 84% for those in residential care will still be payable.

- The income and assets tests will be combined, and a $25,000 annual cap will apply to care contributions for those in residential aged care. A lifetime cap of $60,000 will apply to homecare and residential care contributions. Those in residential care as at 30 June 2014 will not be affected by the changes.
- After this date, those entering care can choose to pay for their accommodation as a lump sum that is fully refundable, via periodic payments, or a combination of both.

The changes may result in increased costs for part-pensioners and self-funded retirees. If you or someone you know is starting to consider their aged care options, it's important to plan ahead and consult your financial planner who can help make sense of this increasingly complex area.

4.5 Centrelink and overseas travel

The Government has tightened the rules concerning receipt of benefits for those who chose to travel or live overseas for long periods.

From 1 January 2014 people who are under Age Pension age will have benefits paid for a maximum of 6 weeks (reduced from 13 weeks) while overseas. Those already overseas when this measure is implemented will not be affected.

Age Pensioners will need to have spent 35 years (an increase of 10 years) or more of their working life in Australia to have the age pension paid while they retire or travel overseas for more than 26 weeks. The payment will reduce and be pro-rated depending on the working years spent in Australia. Those already overseas on 1 January 2014 are not affected by the change, and the current 25 year rule will apply. Age pensioners paid under the Greek or New Zealand Social Security Agreements are exempt from the changes.

The main group of people affected will be those of immigrant background who choose to return to their homeland for an extended period of time after retirement. They will need to be aware of any changes to ensure they have planned ahead should they suffer a reduction in the benefits they receive.

4.6 National Disability Scheme

An allocation of $1.0 billion over four years will be put in place to fund a National Disability Insurance Scheme. This will give personalised care and support to those suffering significant permanent disability, starting from 10,000 people in 2012-13 and increasing to 20,000 people thereafter. Eligibility will be based on an individual's personal circumstances.

4.7 Mature age job seekers

Additional services will be provided to those over 55 who are unemployed or wish to re-enter the workforce from 20 March 2013. They will include reviewing a person's skill set and retraining if required to increase an individual's ability to find employment in the job market. Employers will be given an incentive to hire more mature workers through the introduction of the $1,000 Job Bonus scheme.

Mainly affected will be those on Newstart Allowance who are still a number of years from qualifying for the Age Pension.