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2008 Federal Budget Summary

13 May 2008

The 2008 Federal Budget contained no major surprises, with many of the measures re-iterating previous announcements (including personal tax cuts). While there were no substantial changes to superannuation, there were still some items of interest for advisers and clients. Examples include:

- A broader definition of 'income' for Government support programs, including co-contributions.
- A change to the eligibility thresholds for certain benefits, such as Family Tax Benefit – Part B and the Baby Bonus.
- Further clarity regarding the First Home Saver Accounts.

PERSONAL TAXATION CHANGES

Personal income tax rate and threshold changes

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

Current tax thresholds (2007/08)	Tax rate	New tax thresholds (2008/09)	Tax rate	New tax thresholds (2009/10)	Tax rate	New tax thresholds (2010/11)	Tax rate
\$0 - \$6,000	0%	\$0 - \$6,000	0%	\$0 - \$6,000	0%	\$0 - \$6,000	0%
\$6,001 - \$30,000	15%	\$6,001 - \$34,000	15%	\$6,001 - \$35,000	15%	\$6,001 - \$37,000	15%
\$30,001 - \$75,000	30%	\$34,001 - \$80,000	30%	\$35,001 - \$80,000	30%	\$37,001 - \$80,000	30%
\$75,001 - \$150,000	40%	\$80,001 - \$180,000	40%	\$80,001 - \$180,000	38%	\$80,001 - \$180,000	37%
\$150,001 +	45%	\$180,001 +	45%	\$180,001 +	45%	\$180,001 +	45%

Low income tax offset enhancements

Between 1 July 2007 and 1 July 2010, the maximum low income tax offset will increase gradually from \$750 to \$1,500 per year. As a result, the amount of tax-free income low-income earners can receive each year (and the upper limit to which a partial offset can be claimed) will gradually increase.

	2007/08	2008/09	2009/10	2010/11 (and onwards)
Maximum offset	\$750	\$1,200	\$1,350	\$1,500
Upper income threshold*	\$48,750	\$60,000	\$63,750	\$67,500
Maximum tax-free income	\$11,000	\$14,000	\$15,000	\$16,000

* The lower income threshold will remain at \$30,000 for all years.

Tax payable and potential tax savings

The following table shows the amount of tax payable and tax saved in future financial years for a range of taxable incomes, when compared to the current (2007/08) financial year.

Taxable income	2007/08	2008/09		2009/10		2010/11	
	Tax Payable [#]	Tax payable [#]	Tax saved	Tax payable [#]	Tax saved	Tax payable [#]	Tax saved
\$20,000	\$1,350	\$900	\$450	\$750	\$600	\$600	\$750
\$40,000	\$6,250	\$5,200	\$1,050	\$4,900	\$1,350	\$4,450	\$1,800
\$60,000	\$12,600	\$12,000	\$600	\$11,700	\$900	\$11,250	\$1,350
\$80,000	\$19,100	\$18,000	\$1,100	\$17,850	\$1,250	\$17,550	\$1,550
\$100,000	\$27,100	\$26,000	\$1,100	\$25,450	\$1,650	\$24,950	\$2,150
\$120,000	\$35,100	\$34,000	\$1,100	\$33,050	\$2,050	\$32,350	\$2,750
\$140,000	\$43,100	\$42,000	\$1,100	\$40,650	\$2,450	\$39,750	\$3,350
\$160,000	\$51,600	\$50,000	\$1,600	\$48,250	\$3,350	\$47,150	\$4,450
\$180,000	\$60,600	\$58,000	\$2,600	\$55,850	\$4,750	\$54,550	\$6,050
\$200,000	\$69,600	\$67,000	\$2,600	\$64,850	\$4,750	\$63,550	\$6,050

[#] Does not include the Medicare Levy, or tax offsets other than the low income tax offset.

Tax aspirational goal announced

An aspirational goal has been announced to further reduce the personal tax rates over the next six years. This would see the number of tax rates reduce from four to three (ie 15%, 30% and 40%). The low income tax offset would also increase to provide an effective tax-free threshold of \$20,000 by 2012/13.

Tax-free incomes for older Australians

The table below shows the amount of taxable income that can be received tax-free by older Australians.

Note: Clients aged 60 or over will still be able to receive unlimited tax-free income from pension investments commenced from a taxed super fund.

Taxpayer categories	Tax-free income*			
	2007/08	2008/09	2009/10	2010/11
People aged 55 to 59 using pension investments [#]				
• Singles	\$38,684	\$44,211	\$45,789	\$48,158
• Per member of a couple	\$38,684	\$44,211	\$45,789	\$48,158
People eligible for SATO and not using pension investments				
• Singles	\$25,867	\$28,867	\$29,867	\$30,685
• Per member of a couple	\$21,680	\$24,680	\$25,680	\$26,680

* Does not include the Medicare Levy, but includes the low income tax offset and SATO, where applicable.

[#] Assumes no income from other sources is received.

Increases in Medicare levy thresholds

The Medicare levy low-income threshold will increase to \$17,309 for individuals and \$29,207 for individuals with families from 1 July 2007. The threshold will also increase by \$2,682 for each dependant child.

Senior Australians

The Medicare levy low-income thresholds and phase-in limits for those people eligible for the Senior Australians Tax Offset will increase as follows:

Low-income thresholds	2007/08	2008/09	2009/10	2010/11
Individuals	\$25,867	\$28,867	\$29,867	\$30,685
Families	\$37,950	\$42,000	\$43,500	\$44,500

Phase-in limits	2007/08	2008/09	2009/10	2010/11
Individuals	\$30,431	\$33,961	\$35,137	\$36,100
Families	\$44,647	\$49,412	\$51,177	\$52,353

Medicare Levy Surcharge changes

The Medicare Levy Surcharge income thresholds will increase from \$50,000 to \$100,000 a year for single people and from \$100,000 to \$150,000 for couples. Singles without private health insurance will save up to \$1,000 and couples will save up to \$1,500 from these changes. All Australians who choose appropriate health insurance will continue to benefit from the private health insurance rebate.

Child care tax rebate enhancements

The Government confirmed that, from 1 July 2008, they will:

- Increase the child care tax rebate from 30% to 50% of eligible expenses.
- Lift the rebate limit from \$4,354 to \$7,500 per child.
- Pay the rebate quarterly, rather than annually.

Note: Changes have been announced that impact the Child Care Benefit – see page 13.

50% Education tax refund for eligible expenses

As previously announced, from 1 July 2008, eligible parents will be able to claim a 50% refund every year for up to:

- \$750 of education expenses for each child attending primary school (ie a maximum refund of \$375 per child, per year).
- \$1,500 of education expenses for each child attending secondary school (ie a maximum refund of \$750 per child, per year).

These amounts will be indexed annually from 1 July 2009.

All families who receive Family Tax Benefit – Part A will be eligible and can apply through their tax return. The first payment (in respect of the 2008/09 financial year) will be payable from 1 July 2009.

Dependency tax offset changes

From 1 July 2008, the dependent spouse, housekeeper, child housekeeper, invalid relative and parent/parent-in-law tax offsets will not be available to claimants who earn more than **\$150,000** (indexed annually). From 1 July 2009, the definition of income will be amended to include salary sacrifice super contributions and reportable fringe benefits (see page 7).

OTHER TAXATION CHANGES

Changes to FBT exemptions

Prior to Budget night, it was possible for employees to salary sacrifice certain work-related items, such as laptops, electronic diaries, personal digital assistants and briefcases. To ensure consistency with current rules applying to mobile phones, software and protective clothing, the exemption will now only be available where these items are used primarily for work purposes. For FBT-exempt items already purchased, employees will no longer be able to claim depreciation on the work-related percentage of these items from the 2008/09 income year.

FBT and jointly held assets

Some employers have used the 'otherwise deductible rule' to exempt from FBT a loan interest subsidy (or other fringe benefit) that is paid to an employee's associate, such as a spouse. The law is to be amended to ensure the 'otherwise deductible rule' will not apply to the extent the fringe benefit is provided to the associate. This measure will have effect for new arrangements entered into from 7.30pm (AEST) on 13 May 2008. Transitional relief applies up to 31 March 2009 where an employee has already entered into a salary sacrifice arrangement with their employer. This enables them time to renegotiate packages to avoid an FBT liability in these circumstances.

Withholding Tax and Managed Investment Trusts

New withholding tax rules will be introduced for payments of Australian sourced net income (other than dividends, interest and royalties) made from Australian managed investment trusts to non-resident investors.

The nature of the new withholding tax regime will vary depending on whether foreign investors are resident in countries with which Australia has effective exchange of information arrangements on tax matters. These countries will be specified in Regulations.

Such payments to residents of these countries will be subject to a:

- 22.5% non-final withholding tax for the first income year after the enabling legislation receives Royal Assent;
- 15% final withholding tax for fund payments in the second income year; and
- 7.5% final withholding tax for fund payments in the third and later income years.

During the first income year, investors resident in these countries will be able to claim deductions for expenditure relating to fund payments with the net amount being subject to tax at 22.5%.

Payments to residents of countries with which Australia does not have an effective exchange of information arrangement will be subject to a 30% final withholding tax.

The above measures are to apply from the first income year commencing after the enabling legislation receives Royal Assent (expected to be 2008/09) and covers distributions made directly and through other intermediaries (including custodians) to non-resident investors.

Capital protected borrowings

The Government will amend the rules dealing with the taxation of capital protected borrowings. This amendment will apply to capital protected borrowing arrangements entered into after 7.30 pm (AEST) on 13 May 2008.

A typical capital protected borrowing is a limited recourse loan facility to fund the purchase of listed shares. The investor is protected from a fall in the price of the shares by a capital protection feature. This feature gives the investor the right to transfer the shares back to the lender for the amount outstanding on the loan if the value of the shares falls below that amount.

The benchmark interest rate in the capital protected borrowing rules will be changed from the RBA's indicator variable rate for personal unsecured loans (14.55% at March 2008) to the RBA's indicator variable rate for standard housing loans (9.35% at March 2008).

The interest expense on a capital protected borrowing in excess of this level will be treated as the cost of capital protection and will generally not be deductible.

The current law will continue to apply to existing capital protected borrowing arrangements for a period of five years or the life of the product, whichever is the shorter.

Family trusts

The scope for family trusts to be used to lower income tax by utilising losses will be reduced. From 1 July 2008, the definition of family in the family trust election rules will limit lineal descendants to children or grandchildren of the test individual, or of the test individual's spouse. Effective 1 July 2007, the new rules will also preclude family trusts from making a once-off variation to the *test individual* specified in a family trust election (other than in relation to a marriage breakdown).

Extension of small business CGT concessions

With effect from 1 July 2007, access to the small business CGT concessions will be increased for:

- Taxpayers owning a CGT asset used in a business by a related entity, and
- Partners owning a CGT asset used in the partnership business.

The current small business entity test does not cover business structures where the CGT asset is owned by an entity but is used in a related entity which carries on the business. In addition, for partnerships, the small business entity test requires the taxpayer making a capital gain to be a partner in the partnership and for the asset to be an asset of the partnership.

CGT – cancellation of interests in widely held entities

From 2006/07, the Government will allow taxpayers to calculate their capital gains or losses using the actual proceeds received (rather than the asset's market value) where shares or units in widely held entities are cancelled, surrendered or similarly brought to an end.

Employee share schemes

Based on perceived integrity issues with employee share schemes, the Government has announced it will introduce measures to ensure that, where an election to be taxed on shares up-front is made, the amount above the \$1,000 exemption must be included in the client's tax return. Additionally, an anomaly that may cause double taxation in certain employee share schemes using employee share trusts is to be removed.

'Roots and Branch' Tax Reform

Australia's tax system will be comprehensively reviewed and will encompass Australian Government and State taxes (except the GST) and interactions with the transfer system. The review process will be conducted in several stages. An initial discussion paper will be released by the end of July 2008, with a final report to the Treasurer by the end of 2009.

DEFINITION OF INCOME FOR GOVERNMENT SUPPORT PROGRAMS

From 1 July 2009, the definition of income used to determine eligibility for certain Government support programs will be expanded to include:

- **Salary sacrifice super contributions.** This measure removes the opportunity for clients to use salary sacrifice to increase their entitlement to certain income support payments, family assistance, child support, superannuation co-contributions and financial and retirement savings assistance delivered through the tax system.
- **Net financial investment losses and net rental property losses.** This measure will expand the adjusted taxable income definitions to include net financial investment losses. It also expands the definition of income used for particular tax programs (eg Senior Australians Tax Offset, Medicare levy surcharge and dependency tax offsets) to include net rental property losses and net financial investment losses.
- **Reportable fringe benefits.** The definitions of income used to determine eligibility for certain tax offsets will include reportable fringe benefits. Currently, the Senior Australians Tax Offset and pensioner tax offset use taxable income in their income definition while the dependency tax offset is determined on the basis of the dependant's separate net income. This measure will expand the income definitions for these offsets to include reportable fringe benefits.

SUPERANNUATION CHANGES

Superannuation Clearing House Facility

Funding will be provided over three years to the Australian Taxation Office to establish a Superannuation Clearing House Facility to help employers' meet their fund choice obligations.

This facility, which will be made available from 1 July 2009, will be contracted out to the private sector. The Government has committed to consulting with the industry prior to implementation.

The clearing house will be offered free of charge to small businesses with less than 20 employees and on a fee-for-service basis to larger businesses.

Comment:

- There are already a number of commercial clearing houses operating which will disburse employer contributions to various employee chosen funds (along with the employer's default fund where a choice is not made). It's not clear whether contracting the facility to the private sector would effectively shut existing providers out of the market, or whether multiple clearing houses would be approved.

Definition of income for co-contributions

From 1 July 2009, the definition of income used to determine eligibility for Government co-contributions will be expanded to include salary sacrifice super contributions.

Comments:

- When this measure comes into effect, it will not be possible to make salary sacrifice contributions to reduce income below certain thresholds to qualify for a full (or partial) co-contribution.
- This measure will also impact eligibility for a range of other Government support programs (see page 7).

Temporary resident contributions

Superannuation benefits of temporary residents (excluding New Zealand residents temporarily in Australia) will be paid to the ATO. While the effective date is being deferred to allow for industry consultation, core parts of the policy announced to date include:

- Temporary residents who permanently depart Australia will only be able to claim their superannuation within five years of departure.
- Temporary residents who become permanent residents will have their superannuation transferred back to a superannuation fund with interest.
- Potentially allowing employers to pay temporary residents' superannuation contributions to a super fund or directly to the ATO.
- Annual matching of data by the ATO and the Department of Immigration and Citizenship to identify super funds holding balances for temporary residents. The funds will be notified by the ATO and be required to transfer those balances.

Comments:

- The Government tax slice of temporary resident super is already quite sizable. Up to 15% is applied to employer contributions, an additional 31.5% is deducted if a valid Australian TFN has not been quoted and this is before the PAYG withholding rates are applied to the Taxable component. In any event, if the benefit is unclaimed, the money will be paid to the ATO at that time. A five-year forfeiture rule seems excessive in this context.
- Insurance coverage will be lost (or unavailable) for many temporary residents.
- It's a costly exercise for funds to have to transfer out benefits (annually) to the ATO (particularly if the employer is required to or decides to continue making contributions to the fund for SG purposes).

Same-sex couples

Proposed changes to a wide range of laws will provide for equality of treatment between same-sex and opposite-sex de facto couples. This includes tax, superannuation, social security, health, aged care, veterans' entitlements, workers' compensation, employment entitlements and other areas of Commonwealth administration. The changes do not alter marriage laws.

Most of the changes are to be legislated by 1 July 2009. However, amendments related to superannuation, in particular the tax treatment of superannuation death benefits to a same-sex partner, are expected to come into effect from 1 July 2008.

Currently, unless a same-sex partner meets the stricter definitions of being a financial dependant or an interdependant of a deceased superannuation fund member, they are liable to pay tax on the Taxable component of a lump sum superannuation death benefit. This is in contrast to the tax free status (regardless of age) afforded to married or opposite-sex de facto partners.

FIRST HOME SAVER ACCOUNTS

The Government has confirmed it will introduce legislation effective 1 October 2008, allowing the establishment of concessionally taxed First Home Saver Accounts (FHSAs). The key features, based on the consultation paper released earlier this year and in the 2008 Federal Budget, are:

- The client must be between 18-65 years of age and never have previously bought or built a home in which to live.
- A client must make personal after-tax contributions of at least \$1,000 in each of four separate financial years. However, it will not be mandatory to establish a FHSA with a single minimum contribution of \$1,000.
- In a main change from initial proposals, a Government contribution at a flat rate of 17% on the first \$5,000 (indexed) of personal contributions will apply each year (see below for a comparison). The Government contribution is made in arrears after the ATO receives tax reports from FHSA providers and the income tax returns of FHSA clients.
- Contributions cannot be made once the account balance reaches \$75,000 (indexed). This contrasts with the initial proposal that capped contributions at \$50,000.

- Earnings on the account will be concessionally taxed at 15% in the hands of the FHSA provider (not the client).
- Withdrawals will be tax free when used to purchase or build a first home in which to live, but may have to be transferred to a client's superannuation account in other circumstances.
- A client can only operate one account at a time and, in general, once closed cannot open another FHSA.
- FSAs may be offered by Approved Deposit Taking Institutions which include banks, building societies, credit unions as well as registered trustees of public offer superannuation funds.

Comments:

- The change from a Government contribution linked to marginal tax rates to a flat 17% is not surprising. Many commentators were critical of the lack of equity with the original proposals.
- Clients earning up to \$80,000 pa will now receive an increased Government contribution of \$850 (previously \$750) on the first \$5,000 contributed to a FHSA. Clients with a marginal tax rate of 41.5% and 46.5% who previously would have received a Government contribution of \$1,250 and \$1,500 respectively will now only receive \$850.
- Given the requirement that contributions of at least \$1,000 must be made in each of four financial years, it is questionable whether some clients may avoid these arrangements if they plan to buy in the short term. The money is locked in for at least four years and, if it has to be transferred to superannuation, this may act as a disincentive.
- Costs of administration and uncertainty with take-up rates may see limited numbers of providers in the market (and perhaps very few before 2009 given the timeframe required to build systems and processes).

The tables below compare the end benefits of investing \$10,000 pa in a FHSA (pre and post Budget) and an internet savings account.

Key points to note are:

- Lower income earners are generally better off after the Budget changes, while higher income earners are generally worse off.
- While it may be financially worthwhile investing in a FHSA (pre and post budget) the results may not be sufficiently compelling to justify the reduced flexibility associated with locking into a four year time frame.

Client earning \$70,000 pa (ie 31.5% MTR)			
Year	FHSA (post-Budget)	FHSA (pre-Budget)	Internet savings account
1	\$11,175	\$11,075	\$10,259
2	\$23,020	\$22,813	\$21,013
3	\$35,575	\$35,255	\$32,287
4	\$48,882	\$48,443	\$44,105

Client earning \$90,000 pa (ie 41.5% MTR)			
Year	FHSA (post-Budget)	FHSA (pre-Budget)	Internet savings account
1	\$11,175	\$11,577	\$10,221
2	\$23,020	\$23,848	\$20,863
3	\$35,575	\$36,855	\$31,945
4	\$48,882	\$50,640	\$43,484

Assumptions: Annual contributions of \$10,000. The announced FHSA attracts a Government contribution of 17% of the first \$5,000 contributed per year. The previously proposed FSHA paid a Government contribution of \$750 based on an MTR of 31.5% and \$1,250 based on an MTR of 41.5%. Interest rate is 7.05% in all products. Rates are assumed to remain constant over the investment period. All figures are after income tax (at 15% for FHSA and 31.5% or 41.5% for the internet account).

FAMILY BENEFITS

Family Tax Benefit – Part B

From 1 July 2008, Family Tax Benefit – Part B will only be available to families where the primary income earner has an adjusted taxable income of less than or equal to \$150,000 pa (indexed annually). The taxable income is adjusted to include financial losses and/or tax free pensions or benefits that the primary earner may have had over the year.

From 1 July 2009, the benefit will need to be claimed through Centrelink or Medicare and it will not be able to be claimed through the tax system. It will continue to be paid as either a lump sum at the end of the year, or in fortnightly instalments.

Baby Bonus

From 1 July 2008, the baby bonus will be increased to \$5,000 (indexed annually). From 1 January 2009:

- An income test will be introduced, which will mean that to receive the bonus, the family's adjusted taxable income must be no greater than \$75,000 in the 6 months after the birth of the child (or \$150,000 annualised).
- The bonus will be paid in 13 fortnightly instalments and will also be available to parents who adopt a child under 16 years of age.

SOCIAL SECURITY MEASURES

Bonus payments

Like the previous Government, Labor has announced a series of 'one-off' tax-exempt bonus payments for carers and senior Australians. To receive these payments, people must be receiving (or have made a valid claim to receive) the relevant social security or DVA payment by 13 May 2008.

Bonus payment	Payment amount	For people entitled to receive:
Carer Bonus	\$1,000	<ul style="list-style-type: none">• Carer Payment• DVA Carer Service Pension• DVA Partner Service Pension along with Carer Allowance• Wife Pension along with Carer Allowance
Carer Bonus	\$600	<ul style="list-style-type: none">• Carer Allowance
Seniors Bonus	\$500	<ul style="list-style-type: none">• Age Pension• Veterans Pensions• Widow B Pension• Wife Pension• Seniors Concession Allowance• Mature Age Allowance• Widows Allowance• Partner Allowance

Note: People may be entitled to receive both Carer Bonus payments, totalling \$1,600.

Commonwealth Seniors Health Card (CSHC)

While seniors are required to notify Centrelink when their income exceeds the CSHC limits, there are currently no compliance or review activities in place. Commencing 1 July 2008, data matching and profile based reviews will be introduced to ensure the CSHC is only available to eligible people. Commencing 1 July 2009, income from superannuation income streams paid from a taxed source and salary sacrifice super contributions will be added back to other taxable income for CSHC assessment purposes.

Concession Cards

Commencing 1 July 2008, concession cards issued by the Australian Government will no longer be cancelled when the cardholder travels overseas for short periods (generally up to 13 weeks).

Partner Service Pension

Commencing 1 July 2008, Service Pension age eligibility for partners (which is currently 50 years) will be brought in line with Service Pension age eligibility for veterans (which is currently 60 years for men and 58.5 years for women). This measure will not apply to partners with dependant children, or those who are partnered to a Totally and Permanently Incapacitated veteran.

Child Care Benefit

Child Care Benefit (CCB) will no longer be paid if it is reduced to the former 'minimum rate' under the income test for 'approved care'. Approved care includes long day care and before and after school care. The maximum amount of CCB lost under this proposal is \$28.20 per child per week. The minimum rate will still be paid for 'registered care'.

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