12 May 2009

Federal Budget 2009-10

what it means for financial planning strategies, the economy and markets

Highlights

- Federal Budget to be in deficit until 2015 – this year's deficit set $57.6 billion
- $22 billion to be spent on nation building infrastructure
- concessional superannuation contributions cap halved to $25,000 pa
- first home owners boost extended in full until 1 October 09 and abolished by 31 December 09
- increased cost of private health insurance for high income earners
- employee share plan benefits significantly reduced
- promised tax cuts honoured
- 18 weeks paid parental leave from 1 January 2011
- pensioners to receive an increase of $32.49 pw for singles and $10.14 pw combined for couples on full rate
- carers receive $600 annual payment

what it means for financial planning

tax rates 2009-10 and beyond

residents

The tax rates and thresholds announced in the 2008 Federal Budget were confirmed and are as follows:

tax thresholds for 2009 – '10		tax thresholds for 2010 – '11	
income range pa	**tax**	**income range pa**	**tax**
$0 – $6,000	0%	$0 – $6,000	0%
$6,001 – $35,000	$0 + 15%	$6,001 – $37,000	$0 + 15%
$35,001 – $80,000	$4,350 + 30%	$37,001 – $80,000	$4,650 + 30%
$80,001 – $180,000	$17,850 + 38%	$80,001 – $180,000	$17,550 + 37%
$180,000 +	$55,850 + 45%	$180,000 +	$54,550 + 45%

low income tax offset (LITO)

The maximum amount of LITO will increase as follows:

~ from $1,200 to $1,350 in 2009-10

~ to $1,500 in 2010-11

indicative income tax savings

income (pa)	tax payable	tax saving
	2008 – '09	**2009 – '10**
$35,000	$4,025	$300
$55,000	$11,125	$300
$80,000	$19,200	$150
$100,000	$27,500	$550
$150,000	$48,250	$1,550
$200,000	$70,000	$2,150

Tax calculations include LITO, Medicare levy (not surcharge).

tax-free thresholds for senior Australians

The income thresholds at which senior Australians of Age Pension age begin to have a tax liability will increase due to the increase in LITO and are as follows:

year	single	each member of a couple
2008 – '09	$28,867	$24,680
2009 – '10	$29,867	$25,680
2010 – '11	$30,685	$26,680

The relevant Medicare levy thresholds also increase so that senior Australians do not pay Medicare levy until they pay tax.

tax rates – non-residents

tax thresholds for 2009 – '10		tax thresholds for 2010 – '11	
income range pa	**tax rate**	**income range pa**	**tax rate**
$0 – $35,000	29%	$0 – $37,000	29%
$35,001 – $80,000	30%	$37,001 – $80,000	30%
$80,001 – $180,000	38%	$80,001 – $180,000	37%
$180,000 +	45%	$180,000 +	45%

foreign employment income

A current tax rule which allows Australian resident taxpayers an exemption from Australian tax when they have been engaged in service in a foreign country for a continuous period of at least 91 days has been changed. This foreign income will now be included in the taxpayer's Australian tax return. This is consistent with the practice of taxing the world-wide income of resident Australian taxpayers. The taxpayer will be allowed a tax credit in respect of any foreign tax withheld. Certain workers will be exempt from this change. These include aid workers, charitable workers and certain government employees and those employed on projects deemed to be in the national interest.

age pension and other Centrelink issues

increase in Age Pension age

Qualifying age for the Age Pension is currently 63 and a half for women and 65 for men. The qualifying age for women increases to age 65 by July 2013. Commencing in July 2017, the Government will begin to transition the qualifying age for both women and men to age 67. This will be achieved by increasing the qualifying age by 6 months every two years so that on 1 July 2023 the qualifying age will be age 67. This measure also applies to eligibility for the Commonwealth Seniors Health Card.

income test taper rate increases
From 20 September 2009, the rate at which the pension reduces will increase from 40 cents for each additional dollar of private income to 50 cents in the dollar for singles. For each member of a couple the taper rate will increase from 20 cents to 25 cents in the dollar. Current part-pensioners who are adversely affected by this measure will have their existing rate of payment maintained.

pension increases
From 20 September 2009, the total value of the full rate pension increases by $32.49 per week for single pensioners and $10.14 per week combined for couple pensioners. This includes Age Pension, Disability Support Pension and Carer Payment.

pension bonus scheme
From 20 September 2009, the scheme will be closed to new members. Existing members may continue to accrue benefits under the current rules.

The scheme provides a tax-free lump sum to those who elect to remain in the workforce and delay receiving the Age Pension. The maximum lump sum is accrued after working for five years past Age Pension age. The maximum lump sums are currently $34,815 for a single or $29,077 for each member of a couple, and are also based on percentage eligibility for the age pension when the person ceases work.

Application to join the scheme must be made when the person reaches Age Pension age (currently age 63 and a half for females and age 65 for males).

The scheme will be replaced by a new Work Bonus which gives an exemption from the income test for 50% of the first $500 per fortnight of employment income.

additional payments to carers

A Carer Supplement will be payable to those receiving Carer Allowance and/or Carer Payment. The amount will be $600 to each Carer Payment recipient and $600 to each Carer Allowance recipient for each person in their care. The first payment will be made by 30 June 2009 with subsequent annual payments commencing from 1 July 2010. Recipients of both the Allowance and the Payment will be eligible for both payments which are non-taxable.

certain Commonwealth Seniors Health Card (CSHC) changes abandoned

The Government's 2008 Federal Budget proposal to include the gross amount of tax-free superannuation income in the income test for the CSHC will not proceed. A linked proposal to include in the income test amounts that are salary sacrificed to superannuation will still go ahead and applies from 1 July 2009. To remain eligible for the CSHC, income must be below the threshold which is currently (adjusted) taxable income of $50,000 for a single and $80,000 for a couple.

First Home Owners Boost (FHOB) extended

The FHOB is being extended six months. For contracts entered into on or before 30 September 2009, the FHOB will continue to provide first home buyers with $7,000 for established homes and $14,000 for new homes. It will then be halved to $3,500 and $7,000 for established and new homes respectively, between 1 October and 31 December 2009. When combined with the First Home Owners Scheme (FHOS), this means that first home buyers who enter into a contract:

- on or before 30 September 2009 will receive $14,000 for established homes and $21,000 for new homes; and
- between 1 October and 31 December 2009 will receive $10,500 for established homes and $14,000 for new homes.

From 1 January 2010 when the FHOB ceases, the $7,000 FHOS grant will continue.

private health insurance tax offset and Medicare levy surcharge

As expected, changes to the Private Health Insurance tax offset and Medicare levy surcharge thresholds announced in the media prior to the Federal Budget take effect from 1 July 2010.

pre-Budget situation

A tax offset of 30% of the premiums for Private Hospital (and Extras) Insurance Cover is available to all taxpayers under age 65. For those aged 65 – 70 the offset is 35% and for those aged 70 and over the offset is 40%. This offset can either be deducted from the gross premium or claimed as a tax offset through the taxpayer's tax return.

Taxpayers without adequate private hospital insurance who earn more than specified thresholds are liable to the Medicare levy surcharge. In 2008-09, the thresholds were increased to $70,000 for singles and $140,000 for couples/families. The surcharge is 1% of a taxpayer's adjusted taxable income (ATI). ATI includes taxable income, reportable fringe benefits, rental and other investment losses. The surcharge applies to the taxpayer's whole ATI as soon as the threshold is exceeded.

post-Budget changes

From 1 July 2010, the offset will be means tested, and the surcharge will apply as follows:

means testing thresholds for private health insurance tax offset and Medicare levy surcharge

single income*	family income*	offset < age 65	offset 65 - 70	offset ≥ age 70	surcharge
< $75,000	< $150,000	30%	35%	40%	Nil
$75,001 – $90,000	$150,001 – $180,000	20%	25%	30%	1%
$90,001 – $120,000	$180,001 – $240,000	10%	15%	20%	1.25%
> $120,000	> $240,000	nil	nil	Nil	1.5%

* income definition is ATI, as above. For those crossing age thresholds, application of each threshold is based on day's eligibility.

example: Consider a family with ATI of $190,000. Their current health insurance premium (Hospital and Extras) is $4,500 pa which comes down to $3,150 pa ($262.50 per month) after applying the 30% offset to their premium.

After 1 July 2010 (assuming no change in premium) they will be entitled to a reduced offset of 10% on their health insurance premium which will increase to $338 per month ($4,050 pa). If they choose to opt out of private health insurance they will be subject to Medicare levy surcharge of $2,375 pa.

The family needs to weigh up the options of paying more to retain private health insurance against paying surcharge which amounts to more than half of the new premium cost, but for no benefit.

planning point
If considering delaying or opting out of private hospital cover, individuals should take into account the potential impact of loss of "lifetime rating" (i.e. premiums do not increase due to claims history or subsequently acquired medical conditions), potential difficulties in obtaining cover later in life and the added premium cost.

superannuation

concessional superannuation contributions cap halved

From 1 July 2009, the concessional contributions cap will be halved. The maximum amount of concessional contributions that may be made before penalty tax applies will reduce from $50,000 to $25,000 (indexed) and for those aged 50 years or more, the transitional cap reduces from $100,000 to $50,000. From 1 July 2012, this latter group will be subject to the lower $25,000 (indexed) cap. Indexation is still expected to apply based on increases in Average Weekly Ordinary Time Earnings (AWOTE) in $5,000 increments (rounded down). Concessional contributions include Superannuation Guarantee contributions, salary sacrifice contributions and personal contributions for which a tax deduction is claimed.

planning point
This change impacts higher income earners, those wishing to reduce a potential capital gains tax liability on the sale of an asset and generally people who wish to maximise their superannuation contributions when they can afford to in order to build up their retirement savings, for example itinerant workers including women who may have been out of the workforce and small business owners. It also means that the benefit of the popular transition to retirement strategy for employees aged 55 years or more who commence a pension and sacrifice part of their salary to superannuation, is reduced due to the lower concessional contributions cap.

non-concessional contributions cap remains unindexed

Currently, the non-concessional (i.e. after-tax) contributions cap is $150,000 per annum or $450,000 over a three year period. This cap was due to be indexed from 1 July 2009 to $165,000 per annum. The Government has announced that the current $150,000 per annum limit will remain in place for 2009 – 10. Therefore, there will be no advantage in delaying non-concessional contributions until after 1 July 2009 to take advantage of indexation. In the future, the non-concessional contributions cap will be calculated as six times the level of the indexed concessional contributions cap.

temporary reduction in government co-contribution

The Government is temporarily reducing the matching rate of the superannuation co-contribution and the maximum amount payable to workers. For contributions made between 1 July 2009 and 30 June 2012, the matching rate will be reduced from 150 per cent to 100 per cent and to 125 per cent for contributions made between 1 July 2012 and 30 June 2014. The co-contribution matching rate will return to 150 per cent from 1 July 2014. This means that low to middle income earners will be limited in their ability to build up their retirement savings. For example, workers earning less than $30,342 who contribute $1,000 from their after-tax income will only receive a $1,000 co-contribution from the Government for the next three years.

The income thresholds are as follows:

	income 2008 – '09
lower threshold	$30,342
upper threshold	$60,342

Eligibility for the co-contribution reduces at the rate of $0.05 per $1 above the lower threshold and ceases above the upper threshold in 2008-09. In 2009-10 and later years, the shade out rate will temporarily decrease to 3.333 cents per $1 above the lower threshold.

planning point
Eligibility for the co-contribution is assessed on the individual's assessable income and reportable fringe benefits. From 1 July 2009, the individual's reportable superannuation contributions (e.g. contributions in excess of the Superannuation Guarantee) will also be included in this assessment. Thus, 2008-09 was already the last year in which salary sacrifice contributions could assist eligibility for the co-contribution.

lower minimum pension drawdown extended

In February, the Government announced a halving of the minimum pension drawdown requirements for account based income streams for 2008-09. This measure has been extended for 2009-10.

planning point
Retirees will not be forced to sell investments at deflated prices due to the economic downturn to make pension payments they may not need if they can fund their living costs from other sources.

paid maternity (parental) leave

Commencing 1 January 2011, the Government will provide 18 weeks of taxpayer funded parental leave. Payments will be made to the primary carer. Payments will be at the rate of approx. $544 per week (the current minimum wage) and will be taxable, however will not be counted as income for other (Centrelink) income support. The Government scheme will make payments in addition to what a carer may also receive from any employer provided paid-parental leave. Under the scheme employers will not be required to make superannuation contributions on behalf of employees taking paid parental leave.

Paid parental leave will be means tested and only available where the carer earned less than $150,000 in the financial year prior to the birth or adoption of a child. In addition, the primary carer must have worked at least 330 hours over the previous ten months and also worked continuously for at least ten of the 13 months before the expected birth.

Where parental leave payments are made the family will not be eligible for the baby bonus or family tax benefit B during this time.

employee share acquisition schemes (ESAS) benefits reduced

The Federal Budget includes measures to limit access to ESASs. The measure removes the current ability to defer tax on the value of shares or rights (options) acquired to a later tax year. In addition, the $1,000 exemption available when choosing to be taxed in the year of grant will be limited to those with an Adjusted Taxable Income of less than $60,000. This measure comes into effect in respect of shares or rights acquired under an ESAS after 7.30 pm on 12 May 2009.

ESASs tend to be offered by larger companies as a way of offering employees flexibility in how they receive their remuneration, providing the opportunity to purchase shares tax effectively, and more closely aligning employees' interests with those of the employer. Participation in an ESAS is not limited only to executives or more senior employees, but is required to be offered to a broad base of employees in a company.

Current legislation allows employees to purchase shares in their employer on a before-tax basis and to defer tax on the value of any discount on the purchase price of the shares or rights for up to ten years, or to receive a $1,000 discount if they elect to pay tax on the value of the shares in the year of grant.

planning point

Under this Budget measure, employees with an ATI in excess of $60,000 who participate in an ESAS will lose any tax concessions and will effectively be purchasing shares on an after-tax basis. Loan schemes may become an alternative arrangement for those companies who still wish to offer some form of ESAS.

off-market share buy-backs

An off-market share buy-back is a method by which a company can return surplus capital to its shareholders. Currently a company has a level of discretion in determining how much of the off-market buy-back price is made up of a dividend component (with attendant franking credits) and how much represents a return of capital.

The amending legislation will introduce a formula into the Tax Act which will determine the dividend/return of capital proportions and remove this discretion from the company. In addition, notional capital losses arising from such a buy-back by a listed company will be disregarded.

The date of effect will be when Royal Assent is given to the enabling legislation.

planning point

Participation in off-market share buy-backs may become less attractive from a tax view point, however each offer should be assessed on its merits and considering the financial and tax situation of the shareholder.

what it means for the economy

This Budget has been framed against the backdrop of a sharp contraction in the world economy in late 2008 and early 2009. Virtually all developed economies are now in recession with the deleveraging of corporate and household balance sheets and a collapse in global trade undermining global growth. The flow-on affect to Australia has been swift and profound.

The Government is forecasting that 2009-10 will be a difficult year with Australia's economic output declining 0.5%, its first fall since 1990-91 (Chart 1). Unemployment is expected to rise sharply to 8.25% by June 2010 from the current 5.4% (Chart 2). This assessment is in line with the forecasts of private sector economists who have become progressively more pessimistic in light of the deteriorating outlook.

The impact of the global financial crisis, domestic recession and weakening terms of trade is also evident in the extent of the blow-out in the Budget deficit, which is expected to reach $57.6 billion or 4.9% of GDP in 2009-10 and remain close to that level in 2010-11. Relative to the forecast for 2009-10 contained in last year's Budget, this represents a deterioration of $77 billion. It is expected to take at least six years before the Budget returns to balance.

Against this backdrop, the Government's Budget strategy has two contrasting objectives:

1. provide further fiscal stimulus in the short-term, building on the emergency measures announced in the December 2008 and February 2009 mini budgets and;

2. set the wheels in motion to balance the Budget over the long-term.

Whilst the two mini budgets concentrated on providing cash directly to households to provide a short-term boost to consumer demand, the focus has now shifted to underwriting large long-term investment programs in transport, health, education and communications.

At the same time, the Government has the longer-term task of restoring fiscal balance. For now, this involves winding back "middle class welfare" by restricting access to an array of tax concessions and benefits.

The forward estimates indicate that on the basis of current policy settings, the Budget will move back into surplus in 2015-16. However, given the size of the deficits over coming years (Chart 4), the need for further tough revenue and expenditure measures is an area of policy risk in the period ahead, particularly if the acceleration in GDP in future years does not eventuate.

Other key implications of the Budget are:

- Inflation is forecast to ease further under the impact of weak demand, lower input cost pressures and tighter margins. The annual rate is expected to decline to 1.75% by June 2010, below the lower end of the RBA's 2-3% target band (Chart 3). Budget projections assume inflation will remain below the target band in 2010-11.

- Business investment is expected to contract sharply, impacted by a large decline in corporate profitability, excess capacity and more difficult financing conditions. The Treasury is forecasting that business investment will decline by 18.5% in 2009-10, with the slack being taken up by Government.

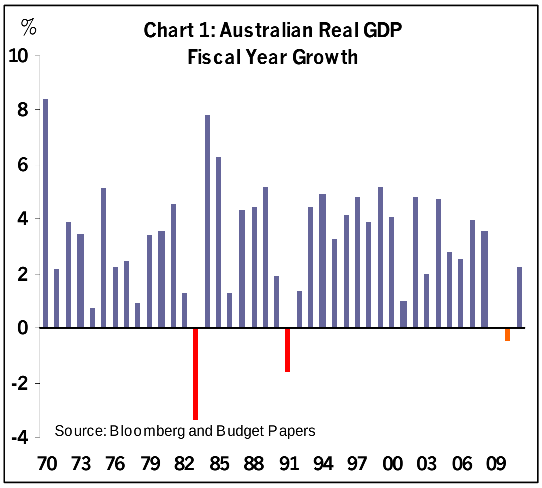
Whilst Australia's Budget position has deteriorated noticeably in response to the world recession, the deterioration is not as significant as that being experienced in the United States, Japan and the United Kingdom. In these countries, deficits as a percentage of GDP are approaching double digits. Australia's relatively favourable fiscal position and financial system strength does enhance the capacity for policy makers to engineer an economic recovery.

budget economic forecasts

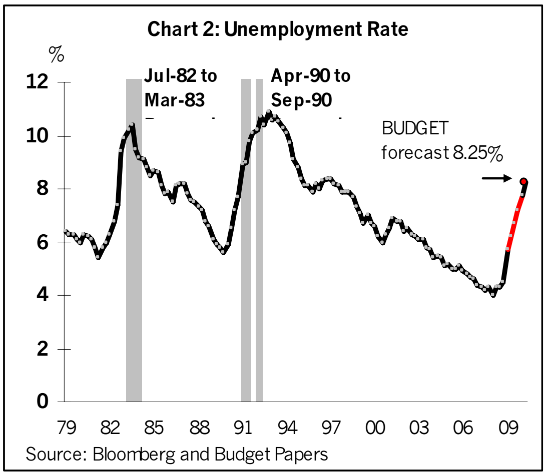
indicator	estimate 2008-09	forecast 2009-10	projection 2010-11
Real GDP (%)	0.0	-0.5	2.25
Employment (%)	-0.25	-1.5	0.5
Unemployment rate (%)	6.0	8.25	8.5
Inflation (%)	1.75	1.75	1.5
Wage price index (%)	4.25	3.25	3.25
Current account deficit (% of GDP)	-3.0	-5.25	-5.75
Budget cash surplus/deficit ($ billion)	-32.1	-57.6	-57.1

Source: 2009-10 Budget Papers, Statement Nos. 1, 2 and 3

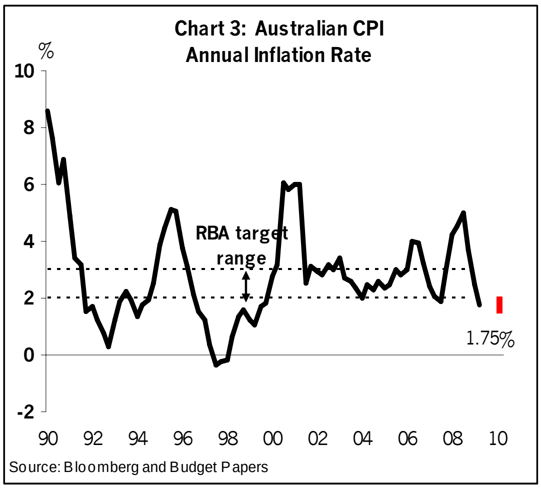
the economic story of the Budget in four graphs



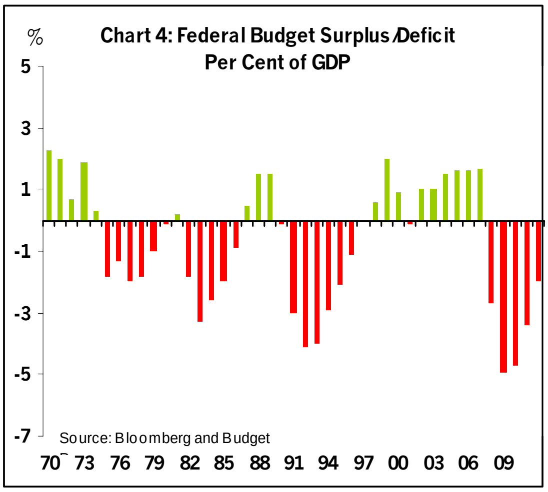
The first decline in annual GDP in 17 years...



....is expected to trigger a sharp rise in the unemployment rate to 8.25% by June 2010...



....with excess capacity and margin pressures reducing inflation to 1.75% by June 2010...



....leading to a massive deterioration in Budget finances as company taxes decline and the government seeks to shore up demand.

what it means for markets

The Government's economic outlook confirms what markets have been progressively forecasting since the collapse of Lehman Brothers in September 2008. This collapse triggered a sudden stop in global economic activity.

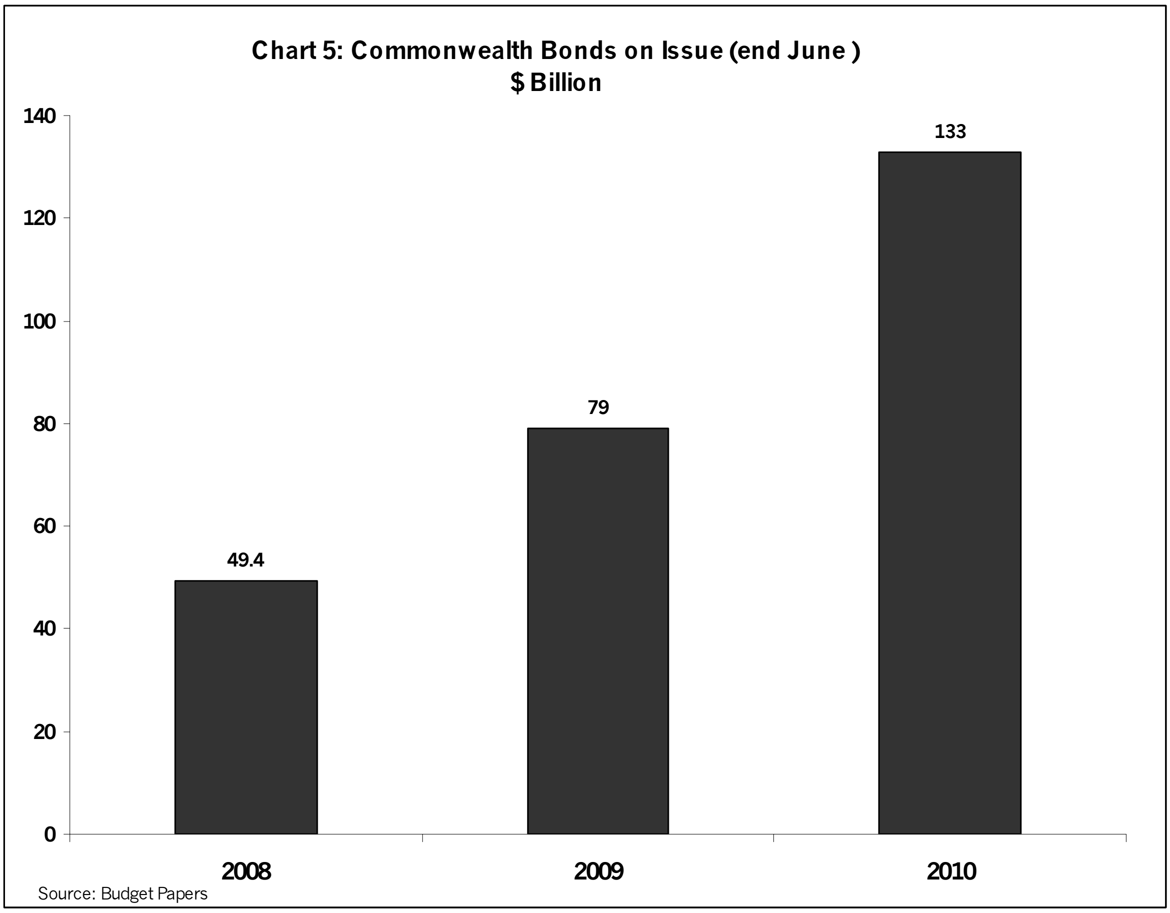
cash rates

- The Government's economic outlook reinforces current market thinking that a low, stable, cash rate regime is likely to prevail until clear evidence of renewed economic growth emerges.
- In its Statement on Monetary Policy released last Friday, the Reserve Bank of Australia indicated that economic growth would only show signs of improvement in late 2009. These forecasts are broadly in line with those of the Government and market expectations.
- With inflation expected to ease until well into 2011, this outlook suggests quite limited upside pressures on cash rates for a lengthy period.
- With policy squarely focussed on reviving activity and considerable uncertainty surrounding the global growth profile the monetary policy bias remains slanted towards lower cash rates.

fixed interest

- The steady run of Budget surpluses prior to 2008-09 meant that, for a number of years, there was no need for the Government to issue bonds. Nonetheless, successive governments prudently decided to maintain a stock of bonds on issue at around $55 billion to maintain a viable market. Those decisions have proved prophetic.
- With the deterioration in the 2008-09 Budget position, and a large deficit in prospect for 2009-10, the Government has already started to ramp up the issuance of Treasury Bonds to cover the spending shortfall. For 2009-10, the Government expects to issue $60 billion in new bonds (Chart 5).
- In the wake of the global financial crisis, investors have favoured sovereign bonds as "safe haven assets". Rapid declines in cash rates and sharp declines in inflationary expectations have justified lower yields. The outlook for weak activity over the next year, low inflation and the likelihood for cash rates to remain low are factors that continue to provide support for bond markets. However, these rates are well below those based on inflation trends and capital demands that prevail in normal market conditions.
- With major nations around the world expected to also issue large volumes of government bonds to fund ballooning Budget deficits, the global supply of bonds is expected to rise dramatically in the years ahead. With increased competition to attract funding, the potential supply represents an increased risk factor for bond yields over the medium-term, particularly when the Government is also providing a guarantee over the debt of major financial institutions.

Chart 5: Commonwealth Bonds on Issue (end June) $billion



Source: Budget Papers

shares

- It has been evident for the past six months that the economic outlook underlying the Budget forecasts do not present a favourable climate for business. Corporate profits are expected to decline with margins under pressure from soft demand.
- After a stream of large downward earnings revisions over the past six to nine months, the implications of the Budget outlook for business profits have largely been captured in analysts' revised earnings expectations. Profit estimates for the 2008-09 and 2009-10 fiscal years have been sharply reduced although more recently the pace of downgrades appears to have slowed.
- Australian businesses have responded with remarkable speed to this weaker outlook, aggressively resizing operations and implementing cost reduction strategies to rebuild profitability. At the same time, companies have cut dividends and raised new equity capital to strengthen balance sheets.
- Current equity market pricing appears to have adjusted to the more pessimistic earnings outlook. As a result of the sharp fall in market prices over the last 18 months, the Australian market's price/earnings ratio is now below its long run average.

~ In addition, notwithstanding recently announced dividend reductions, the dividend yield of the Australian market remains in excess of 5%. This is the first time in over 30 years that the yield on equities has exceeded the cash rate.

~ The outlook for many large listed Australian companies is more significantly influenced by economic and financial developments offshore than by policies announced in the Budget. Consequently, we would not expect the Budget to have a major near term impact on the level of the stock market index.

~ The funding of infrastructure needs in the education, health, communications and transport sectors should provide support to industries in the building and construction, communications and engineering sectors and those with expertise in managing infrastructure projects. However, this capital works program has been well telegraphed to markets, and is probably now reflected in prices. Meanwhile, investors have to grapple with the considerable uncertainty concerning the timing of these projects.

~ The reduction in tax concessions on private health insurance and superannuation are potentially negative for businesses operating in these areas.

what it means for you

We encourage you to seek expert advice from your financial adviser, as now more than ever there is a need for sound financial advice.

You adviser can work with you to explore ways you may benefit from new opportunities or changes needed as a result of this years budget helping you to make the right choices with your money.

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Sydney
Level 31, Grosvenor Place
225 George Street
Sydney NSW 2000
Ph 02 9373 7000
Fax 02 9373 7111
Toll free 1800 626 881

North Shore
Level 12, 815 Pacific Highway
(Cnr Pacific Highway & Help St)
Chatswood NSW 2067
Ph 02 9410 9366
Fax 02 9413 1181
Toll free 1800 626 881

Parramatta
Level 2, 60 Phillip Street
Parramatta NSW 2150
Ph 02 963 57728
Fax 02 9633 4152
Toll free 1800 626 881

Newcastle
Level 3, 251 Wharf Road
Newcastle NSW 2300
Ph 02 4927 5600
Fax 02 4927 5464
Toll free 1800 626 881

Melbourne
Level 19, 459 Collins Street
Melbourne VIC 3000
Ph 03 8627 1700
Fax 03 9614 7875
Toll free 1800 626 881

Brisbane
Level 9, 300 Queen Street
Brisbane QLD 4000
Ph 07 3100 1900
Fax 07 3100 1911
Toll free 1800 626 881