



## May 2018

It's May, and many parts of the country will be grateful that cooler Autumn temperatures have finally arrived. On the national economic stage, this year's Federal Budget was handed down by Treasurer Scott Morrison and our articles reflect the impact it may have on you, along with consideration of changes to come with an election looming.

April was a month of market volatility against a backdrop of ongoing global economic growth. In the US, 10-year bond yields broke through 3 per cent for the first time since late 2013. This, along with rising commodity prices, reignited inflationary fears and pushed the US dollar sharply higher. Oil prices (using the benchmark Brent Crude) rose more than 5 per cent in April, and 44 per cent for the year, to around US\$74.5 a barrel. Spot iron ore prices rebounded 3 per cent in April to US\$67.5 a tonne. The strong US dollar was behind the Aussie dollar's sharp fall to around 75.5 US cents.

In contrast to the US, local inflation is stubbornly low. The March quarter consumer price index (CPI) lifted 0.5 per cent for an unchanged annual rate of 1.9 per cent. While secondary education, household power, pharmaceuticals and vegetables are rising faster than the headline rate, prices for women's clothing, household appliances, audio and computer equipment are falling. National house prices recorded their smallest annual growth in over 5 years in March, with the CoreLogic Home Value Index up just 1.2 per cent. Consumer confidence improved over the month with the ANZ/Roy Morgan rating up 2.1 per cent to a 5-week high of 118.4 in the final week of April. The Reserve Bank's cash rate remains steady at a record low 1.5 per cent where it is expected to stay for some time.

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# What will the Budget mean to you?



The Budget promises to deliver a strong economy, more jobs, guaranteed essential services and the government living within its means. So what does this mean to you?

## Encouraging tax cuts

There's immediate relief for Australians on low to middle incomes, as well as light at the end of the tunnel for higher-income earners. Those earning up to \$90,000 will get a tax cut of up to \$530 via an increase to the low and middle income tax offset as of July 1 2018.

Having raised it from \$80,000 to \$87,000 in 2017, the government is now bumping up the 37c on the dollar threshold to \$90,000. By 2024-25, that threshold will be eliminated and those earning \$200,000 or less will face a top tax rate of no more than 32.5c in the dollar.

## Boomer benefits

As they have with every other life stage, the baby boomers look set to reinvent old age and how it is funded.

Older Australians who want to keep working can take advantage of the Pension Work Bonus being raised from \$250 to \$300 a fortnight. (This will allow them to earn up to \$7,800 without having their pension reduced.)

The Pension Loan Scheme is also being expanded. This means many more retirees including full rate pensioners and self-funded retirees can boost their retirement income by up to \$17,787 a year by borrowing against the equity they have in their home.

Older Australians wanting to stay in their own homes despite confronting medical challenges, can take advantage of the

additional 14,000 high-level home care packages that have been provided. There's also more money for palliative care and mental health services for those in residential aged care.

The Pharmaceutical Benefits Scheme has received a \$1.4 billion boost to list more medicines including those to treat breast cancer and relapsing-remitting multiple sclerosis.

## Super fees slashed

There's not a lot in this Budget for younger Australians but they will at least get a better deal on their super.

Fees on accounts with balances of \$6,000 or under will be capped at 3 per cent (of the balance). Exit fees will be banned when super funds are consolidated. The ATO will be supported to proactively consolidate any inactive super accounts a taxpayer has with their active account.

Rather than being the default option, life insurance will be offered on an opt-in basis for super fund members under 25.

## Cigs up, beer down, commutes quicker, power cheaper

In more bad news for smokers, the Government is cracking down on the sale of black-market tobacco. But Australia's craft beer lovers may enjoy more affordable artisanal ales following changes to the excise rate on small kegs.

The Government is funding infrastructure projects across the country. Among other benefits, this should result in safer, less congested roads. Australians will also benefit from the introduction of the national energy guarantee which is predicted to result in the power bill of an average household falling by \$400 from 2020.

## Counterfactual cost savings

Although these cost savings won't affect the hip pocket, the measures are welcome news. The planned 0.5 per cent increase to the Medicare Levy to fund the NDIS has been scrapped. The franking credits cash refund remains. Negative gearing and the capital gains tax discount on investment properties has not been curbed. Furthermore, the government is funding its largesse through measures such as cracking down on welfare overpayments and targeting tax-shy multinationals rather than jacking up taxes and levies on working Australians.

Having taken the GFC and end of the mining boom in its stride, Australia's AAA-rated economy continues to power along. The Budget is even set to return to modest surplus in 2019-20 and, barring any unforeseen events, the Treasurer looks likely to achieve the goals he has set.

*If you'd like more information on how the measures contained in the Budget will affect you, please give us a call.*



# FRANKING DIVIDENDS FACING THE ... CHOP...



Here we go again. Superannuation could be about to undergo more change with the federal opposition announcing it will end cash refunds of franking credits on share dividends if it wins the next election. The change would have a significant impact on people paying little or no tax, especially self-funded retirees in pension phase. Seniors groups are up in arms, but many Australians have been left wondering 'franking what?'.

Dividends paid by Australian companies are not just a source of income for investors; they also offer potential tax benefits in the form of franking credits, also known as imputation credits.

## What is dividend imputation?

Dividend imputation was introduced by the Hawke/Keating Government in July 1987 to end the double taxation of company profits. Before then, companies paid tax on their earnings and shareholders were taxed on the dividends paid out of profits at their marginal rate.

Under the current system, if the company has already paid tax on the income the Australian Taxation Office (ATO) gives shareholders a tax credit.

Dividends on shares with imputation credits are called franked dividends and may be fully or partly franked, depending on the amount of tax the company has paid and in what country. There are no credits for tax paid on overseas earnings.

The system was made more generous in July 2000 when the Howard/Costello Government allowed excess franking credits to be paid as a cash refund. The Labor Party proposal effectively restores the original tax treatment of dividends.

## How does it work?

If the proposal is adopted, it will have no impact on investors on a marginal tax rate above the 30 per cent company tax rate. But investors who pay less than 30 per cent tax stand to lose some of their share income.

Say an Australian company 'OzInvest' makes pre-tax earnings of \$1 a share. It pays tax at the company rate of 30 per cent, or 30c a share, and returns the remaining 70c to shareholders as a fully franked dividend. The level of benefit you receive depends on your marginal tax rate.

## High marginal tax rate

Sarah pays tax at the top marginal rate of 47 per cent including the Medicare levy. She has 100 shares in OzInvest and receives \$70 in dividends plus a \$30 imputation credit.

Sarah's taxable income on the dividend is \$100 (after adding the \$30 imputation credit to her \$70 dividend), so she's liable for tax of \$47. However, this is offset by the \$30 imputation credit leaving her with only \$17 tax to pay.

## Low marginal tax rate

Alice also receives taxable income of \$100 from OzInvest, but she pays tax at the lowest marginal rate of 21 per cent (including Medicare levy). As the

imputation credit of \$30 is more than her tax payable of \$21, she currently receives a tax refund of \$9 cash. Under the new proposal, she would lose \$9 a share.

## Paying no tax

Many retirees or people who earn below the annual tax-free threshold of \$18,200 pay no tax at all on their fully franked shares. Because franking credits are fully refundable, they can claim a full refund from the ATO.

David has a self-managed super fund in pension phase which pays no tax and he has no other income. He receives a \$70 dividend from OzInvest and claims a cash rebate of the full \$30 franking credit. Under the new proposal, he would lose this \$30 a share.

## Still at proposal stage

Of course, the proposal is just that. With a federal election not due until next year, the earliest it could come into effect would be July 2019 and only if passed by both houses of parliament. Already there are hints of compromise, with Labor leader Bill Shorten saying full and part-pensioners and people on government allowances will be exempt from the change.

It's too early to be alarmed or to change investment strategy based on what may or may not happen in future. But it is important to understand how the proposed changes could potentially affect you and what alternative investment strategies may be beneficial.

*If you would like to discuss your retirement income strategy, please give us a call.*



# Home & away with super

Australians buying their first home or downsizing in retirement are about to receive a helping hand thanks to new superannuation rules which come into effect on July 1. From that date, first home buyers will be able to contribute up to \$30,000 into their super fund towards a home deposit while downsizers can put up to \$300,000 of the proceeds of selling the family home into super.

This new measure has been devised to assist first home buyers, many of whom have struggled to save a deposit as rising prices put even entry level properties out of reach.

At the other end of the scale, the change is envisaged to help older homeowners who frequently find themselves in large houses while trying to survive on a modest super balance or the aged pension.

Here's how the Federal Government hopes to improve the situation at both ends of the property market.

## Buying a home

Under the new First Home Super Saver (FHSS) scheme, individuals can arrange for up to \$30,000 to be deducted from their pre-tax income and put in their super account.<sup>i</sup> They can then withdraw 85 per cent of that money (\$25,500), plus any interest they've earned on it, to use for a home deposit. In the case of a couple, both partners can save \$30,000, meaning a deposit of \$51,000 (i.e. 85 per cent of \$60,000) plus interest can be accumulated.

### So what's the catch? It's complicated.

For starters, individuals can only contribute \$15,000 into their FHSS account in any one year. What's more, the compulsory 9.5 per cent super contributions made by employers can't

be accessed; additional voluntary contributions need to be made. The annual contributions cap of \$25,000 cannot be exceeded; this includes all voluntary contributions plus employer's Super Guarantee contributions.

When the money is withdrawn, it is taxed at the individual's marginal tax rate minus a 30 per cent tax offset. Effectively, that means most people will pay little or no tax although higher-income earners on high marginal rates will still pay some tax.

## Selling a home

Under the Downsizer Super Contribution Scheme (DSC), homeowners who are 65 or older can put up to \$300,000 of their home sale proceeds into their super provided it's their place of residence and they've owned it for at least 10 years.<sup>ii</sup> In the case of a couple, both partners can deposit \$300,000 (collectively \$600,000) into super.

### What's the catch?

Unless you're a wealthy retiree looking for a tax break there doesn't appear to be one.

For those who already have more than \$1.3 million in super, adding a \$300,000 downsizer contribution will breach the \$1.6 million balance transfer cap which is the maximum balance that can be held in a tax-free super pension account. Given the current generation

of Australians have been retiring with average super balances of well under \$300,000, that is unlikely to be an issue for most downsizers.

## What do you do now?

If you are looking to purchase your first home, you will need to check your super fund allows FHSS contributions and, more importantly, withdrawals. You'll then need to arrange for your employer to deduct voluntary contributions of up to \$15,000 a year. When you want to access your money, you will have to acquire a 'FHSS determination' (essentially a balance statement) from the Commissioner of Taxation before requesting your super fund to release the money.

Following approval of this request, your super fund deposits your FHSS money, minus any tax you've incurred, into your account. You then have 12 months to sign a contract to buy or build a home.

If you are looking to downsize your home, you will first need to check your super fund accepts downsizer contributions. If it does, you can deposit up to \$300,000 within 90 days of receiving the proceeds of the sale. You'll have to fill in and send your super fund a 'downsizer contribution form' before, or when transferring the money into your account.

*If you're hoping to either buy your first home or downsize, call us to discuss how the changes to super can save you money.*

<sup>i</sup> <https://www.ato.gov.au/Individuals/Super/Super-housing-measures/First-Home-Super-Saver-Scheme/#Howyoucansaveinsuper>

<sup>ii</sup> <https://www.ato.gov.au/Individuals/Super/Super-housing-measures/Downsizing-contributions-into-sup-erannuation/#Eligibilityformakingadownsizercontri>