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FEDERAL BUDGET 2017

KEY ANNOUNCEMENTS / 10 MAY 2017

On 9 May 2017, Treasurer Scott Morrison delivered Australia's Federal Budget 2017.

In the Budget, the Government vows to make the 'right choices' for Australia, and says its plan is based on principles of fairness, security and opportunity. As expected, the key theme for many of the proposed superannuation and tax changes announced in the Budget were related to the reduction of housing affordability pressures.

In the following update, we provide a summary of the key announcements from the Budget from the perspective of investors, and what these could mean for markets.

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Reducing pressure on housing affordability

The Government will remove some of the barriers that currently exist for older people who wish to downsize their home. This is to free up housing stock for young families who are starting out. Older Australians will also be given greater flexibility to contribute proceeds from the sale of their home to superannuation. Australians wishing to save for their first home will be allowed to build a deposit inside superannuation which will help boost savings.

What's changing?

Barriers will be reduced for those aged 65 and over who wish to downsize their home

- People aged 65 and over will be able to make a non-concessional (post-tax) contribution into their superannuation of up to $300,000 from the proceeds of selling their home.
- The existing contribution rules for people aged 65 and over, and restrictions on non-concessional contributions for people with balances above $1.6 million, will not apply to contributions made under this new special downsizing cap.
- This measure will apply to a principal place of residence held for a minimum of 10 years.
- Both members of a couple will be able to take advantage of this measure, meaning $600,000 per couple can be contributed to superannuation.
- These changes will take effect from 1 July 2018.

Voluntary contributions will be allowable under the First Home Super Saver Scheme

- Voluntary contributions under this scheme will need to be made within existing superannuation caps. The total concessional contributions an individual can make from both compulsory employer contributions and voluntary contributions including those made under the scheme cannot exceed $25,000 in 2017-2018.
- Voluntary contributions of up to $15,000 per year and $30,000 in total will be allowed.
- Employees will be able to take advantage of salary sacrifice arrangements to make pre-tax contributions.
- Self-employed individuals can claim a tax deduction on personal contributions, meaning savings effectively come out of pre-tax income.
- The amount of earnings that can be released will be calculated using a deemed rate of return based on the 90-day Bank Bill rate plus three percentage points. Withdrawals will be available from 1 Jul 2018 and will be taxed at marginal tax rates with a 30% offset applied.
- These changes will take effect from 1 July 2017.

Capital gains tax discount will increase for investors in affordable housing

- The Government will provide an additional 10% capital gains tax (**CGT**) discount to resident individuals investing in qualifying affordable housing. Investors will be entitled to a 60% discount on CGT (instead of the traditional 50% discount on CGT).
- To qualify for the additional discount, housing must be provided at below-market rent and made available for eligible tenants on low to moderate incomes. Tenant eligibility will be based on household income thresholds and household composition.
- The affordable housing must also be managed through a registered community housing provider and the investment held as affordable housing for a minimum of three years.
- These changes will take effect from 1 July 2018.

Superannuation integrity measures

What's changing?

Limited recourse borrowings arrangements will be included in a member's total superannuation balance and transfer balance cap

- The outstanding balance of a limited recourse borrowings arrangement will now be included in a member's annual total superannuation balance.
- The repayment of the principal and interest will be a credit in the member's transfer balance account.
- These changes will take effect from 1 July 2017.

Provisions around non-arms length transactions between a member of a super fund and a related party will be strengthened

Business tax measures

What's changing?

Tax offset for small businesses

- Businesses with a turnover of less than $10 million per annum will continue to be allowed to immediately write off expenditure up to $20,000.
- This existing arrangement has been extended to 30 June 2018.

Personal taxation

What's changing?

Medicare levy will increase to fund the National Disability Insurance Scheme

- The Medicare levy will increase by 0.5% from 2% to 2.5% of taxable income. This is to help fund the $22 billion National Disability Insurance Scheme and avoid future budget black holes.
- The effective highest marginal tax rate will therefore be 47.5% (45% + 2.5% Medicare levy).
- This change will take effect from 1 July 2019.

Budget repair levy will be phased out

- As part of the Federal Budget 2014, the Government introduced a temporary Budget Repair levy of 2% on the part of a person's taxable income which exceeds $180,000. This levy is due to be phased out from 1 July 2017.

Deduction of travel expenses for residential rental property will no longer be allowed

- The Government will disallow deductions for travel expenses relating to inspecting, maintaining or collecting rent for a residential rental property.
- This change will take effect from 1 July 2017.

Integrity measures for the small business CGT concessions will be introduced from 1 July 2017

Stronger rules for foreign investors

The Government will place a limit on foreign ownership of new developments, as well as introduce an annual charge on foreign owners who buy residential property and leave it vacant. It will also tighten the foreign investor tax integrity rules to reduce the avoidance of CGT on Australian property.

What's changing?

Foreign ownership of new developments will be limited

- A 50% cap on pre-approved foreign ownership in new developments will be introduced.
- Foreign owners of residential real estate will be encouraged to rent out their properties by applying an annual charge of at least $5,000 where a property is left vacant or not available for rent for six months or more each year.
- Foreign or temporary tax residents will no longer be allowed to claim the main residence CGT exemption, and the Government will increase the withholding rate from 10% to 12.5%. It will also increase the number of foreign residents caught by the regime by reducing the threshold from $2 million to $750,000.
- These changes will take effect from various dates post-Budget night.

What does it mean for investors?

Overall, the Federal Budget appears to relatively balanced for investors, with arguably a slightly negative tilt. It is primarily focused on the revenue side of the equation, which will likely impact investors and financial markets—but only to a small degree.

The bank levy and the tightening of negative gearing rules are expected to be detrimental for both equity and property investors. However, increased spending on infrastructure and health should be beneficial to the overall economy and companies focused on these sectors. Housing initiatives should see increased allocations to superannuation funding, which should benefit markets and investors. The key changes for investors are:

Largest domestic banks will be impacted by a levy

A levy will be placed on the five banks with assessed liabilities of $100 billion or more. This is designed to raise $6.2 billion in revenue. However, the levy will also impact the profitability of these banks, which may impact shareholders via both lower market prices and dividends. It is still too early to know what the exact impact will be.

Increased infrastructure spending

The infrastructure sector is set to benefit from a $70 billion increase in spending between 2013-2014 and 2020-2021. The Government will fund the new Western Sydney Airport at Badgerys Creek, spend $8.4 billion on a Melbourne-Brisbane inland rail freight link, and pour $500 million into upgrading Victoria's battling regional rail network. This will create new jobs, be stimulative for business, and may open up future privitisation opportunities for investors over time.

Stricter rules around negative gearing

Property investors will be negatively impacted by stricter rules around negative gearing, particularly with regards to deductions for travel. Foreign property investors will also be hit by an annual $5,000 levy for leaving 'ghost houses' vacant for more than six months. Conversely, first home owners will receive a minor boost by being allowed to salary sacrifice an additional $30,000 into their superannuation funds to help save for a deposit. Home owners over the age of 65 will also benefit as they will be able to make a non-concessional superannuation contribution of up to $300,000 from the sale of their principal residence. This is provided they have lived there for at least 10 years.

Instant asset tax write-off for small businesses

Small businesses will benefit from an extension to the $20,000 instant asset tax write-off introduced in the Federal Budget 2016. The extension will last for another year, and has also been made available to businesses with an annual turnover of up to $10 million—up from $2 million. The Federal Government is also offering states and territories up to $300 million in exchange for reducing red tape for small businesses.

Extra funding for healthcare

The healthcare sector is likely to benefit from new laws guaranteeing the future of Medicare and the Pharmaceutical Benefits Scheme. There will also be an extra $2.8 billion in funding for hospitals and additional funding for medical research, new medicines and mental health.

Increase to the Medicare levy

While this does not directly impact investors or markets, the increase in the Medicare levy will reduce disposable income when it is introduced on 1 July 2019. In an environment of slack wage growth and higher living costs, this could impact consumption—especially discretionary retail.