NEWSLETTER
April 2019

alpha
ADVISERS GROUP

Introduction

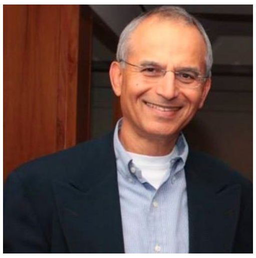
Welcome to our newsletter for April 2019. A bumper edition, this one, as we reflect on the effects of the federal Budget from earlier this week. Whether the Treasurer's announcements come to pass depends on what happens next month in the Federal election. But our analysis will help you make up your mind. We also take a look at the impact of a change that was introduced in last year's Budget. Have a read and see if you are affected.

Famous People in Finance – John Maynard Keynes

John Maynard Keynes (Baron or Lord Keynes to his friends) was a British Economist in the first half of the 20th Century. In 1999, Time Magazine nominated him as someone who may 'have saved capitalism.' Keynes' key insight was that the Government could and should influence the economy by acting in ways that smoothed the boom-bust cycles inherent in private commerce.

Basically, he argued that Governments should spend more during low economic times, using borrowed money if need be, to boost a lagging economy. At times when the private economy is booming, Government can act to slow the economy, mostly through higher taxation. Either way, Keynes championed using Budgets to impact the economy. Australia's Budget went into deficit following the GFC, and only this year is returning to surplus. 'Keynesian economics' is alive today.

Cindy Dahiya
02 9904 0725
cdahiya@alphaadvisers.com.au
www.alphaadvisers.com.au



Deshwant Dahiya
02 9904 0725
ddahiya@alphaadvisers.com.au

The 2019 Federal Budget

This year's Budget is an unusual one. It has been brought forward a month to accommodate the Federal election that is likely to be held in May. What is usually our 'one night in May' has become a big night in early April.

The upcoming election means that the following analysis needs to be read with a caveat: a change of Government may and probably will mean that at least some of the changes announced in the April Budget will not happen. The Federal opposition has already stated it will make an economic statement in the third quarter of the year (between July and September) if it wins office in May. That will basically become a new Budget to take us through until May of 2020.

The leader of the Federal opposition, Bill Shorten, gave his Budget response last night – too late for us to include his comments in this week's newsletter. But we will aim to include his response in a follow up article we intend to write next week.

The Budget Surplus

For the first time since 2008, the Commonwealth Budget will be in surplus. This means that forecast Government spending over the 2019/2020 financial year is expected to be less than Government revenue.

The return to surplus led Treasurer Josh Frydenberg to state that the Budget was 'back in black.' This has led to several commentators observing that this is probably the first time that the Budget speech opened with a reference to AC/DC. Total Government revenue is expected to be $505.5 billion and total Government spending is expected to be $500.87 billion (unless otherwise stated, all figures and statements come from the Federal Government, www.budget.gov.au). This means that the surplus represents 0.9% of revenue. As a level of saving, that is not quite the 9.5% that compulsory super puts aside for all working Australians. But it is a saving, nonetheless.

Government revenue is expected to rise from $485.17 billion in 2018/2019. This is an increase of 4.2% and is mostly due to increased income taxes. Income taxes are one of five major sources of **Government revenue:**

Form of Revenue	Things Like	How Much
Income Tax	Individual and company taxes	$342.74 billion
Sales Taxes	GST	$69.08 billion
Excise and Customs Duties	Fuel and tobacco duties	$45.69 billion
Other Indirect Taxes	Major bank levy	$8.88 billion
Non-Tax Income	Sales, interest and dividends	$39.12 billion
Total		**$500.87 billion**

Government spending is expected to rise from $487.34 billion in 2018/2019. It is spread across 14 major categories:

Category of Spending	Things Like	How Much
Social Security and welfare	Pensions, family assistance	$180.12 billion
Health	Medicare, pharmaceutical benefits	$81.78 billion
Education	Universities, TAFEs, schools	$36.35 billion
Defence	Army, Navy, Air Force	$32.24 billion
Public services	Foreign aid, government super	$23.61 billion
Transport and communication	Rail, road, sea	$9.04 billion
Fuel and energy	Petrol for those government cars	$8.17 billion
Mining, manufacturing, construction	Grants	$3.42 billion
Housing and community amenities	Public housing	$5.91 billion
Public order and safety	Courts and legal services	$5.92 billion
Recreation and culture	Broadcasting, national parks	$3.85 billion
Agriculture, forestry and fishing	Grants to industries	$2.87 billion
Economic affairs	Tourism, labour market assistance	$9.3 billion
Other purposes	Public debt interest, payments to states	$98.29 billion
	Total	**$500.87 billion**

The Budget's Impact

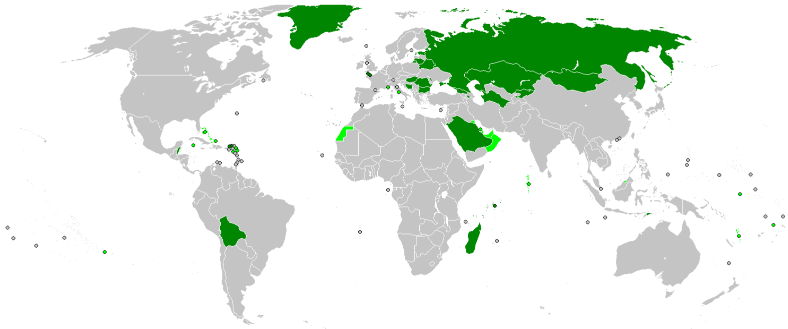
Unsurprising, as there will be an election next month, very few people will be negatively affected by this year's budget. For most people, the budget is either neutral or positive. Let's take a look at some specific areas addressed by the budget.

Taxation

For most **individual taxpayers**, the budget contains good news when it comes to personal tax, although much of the effect of this good news is deferred until later years. For example, in 2024/25, the 32.5% tax bracket will be lowered to 30%. What's more, by this time, there will only be three tax brackets. The 30% bracket will include people earning between $45,000 and $200,000. This is estimated to represent 94% of all taxpayers by that time.

Interestingly, you could argue that this means that Australia is moving away from a progressive system of income tax. We discussed progressive tax in a previous post. Progressive income tax means that, as people's taxable income rise the proportion of each additional dollar that they pay as tax also rises. It is designed to place more of the income tax burden on higher income earners who can more easily afford such taxes. When 94% of taxpayers are all paying the same rate of marginal tax, the system becomes much less progressive. Australia's personal income tax system could almost be argued to have become a **flat tax system**.

There will still be three income tax brackets, and 6% of taxpayers will be paying a tax rate other than 30%, so the system won't be a pure flat tax system. But it will be very close. This will make Australia somewhat unique, especially amongst developed economies. Around the world, very few developed economies employ a flat tax system, as shown by the countries shaded green on this world map (source: wikicommons):



Despite the fact that flat taxes are not common, some argue that flat taxes are associated with strong economic growth in many of the countries coloured green on the map above - especially those that were members of the former Soviet Union and had a long way to catch up (see, for example, the thoughts of Kyle Williams in the Spectator, February 2018).

Coming back to our own hip pockets, people earning between $18,201 and $37,000 a year will receive 'tax relief' of $255 (people earning less than $18,201 do not pay tax on this income at all). People earning between $37,000 and $48,000 will effectively pay somewhere between $255 and $1,080 less tax (within this bracket, the more you earn the greater the tax benefit). Those on $48,000 to $90,000 a year will receive tax relief of $1080. Once your income exceeds $90,000, the amount of the tax cut starts to fall. People earning $126,000 or more will not receive any tax relief at all.

These reduced taxes will be delivered in the form of a combination of tax offsets, basically meaning that you get the benefit through a larger tax refund when you lodge your first tax return after the end of the current financial year.

Businesses get some tax benefits as well. The instant asset write-off threshold will increase from $25,000 to $30,000. This means that assets worth less than $30,000 can be expensed in the year in which they are purchased, rather than needing to be depreciated over an extended period. The size of the business that can claim this benefit has also increased - any business with revenue less than $50 million per year will be eligible. This benefit takes immediate effect – so expect some extra business spending before June 30 this year.

In addition, the reduction in the small business tax rate to 25% is now proposed to take effect from 2021/22.

Superannuation

Once upon a time, you could bet your life that the federal budget would include substantial changes to superannuation. Not anymore. This year's budget contains very little in the way of changes to superannuation. There will be just a few minor changes, targeted at people who are already aged in their 60s. From 2020/2165 and 66-year-olds will be allowed to make voluntary super contributions without needing to meet a work test.

This is great news for Malcolm Turnbull, who turns 66 in 2020 and, of course, no longer meets the work test.

Spousal contributions will also be available for people aged 70 to 74 (currently, they can only be made for people aged up to the age of 69).

Infrastructure Spending

As is probably appropriate given the surplus, a substantial amount of infrastructure spending has been announced. Infrastructure spending always has the effect of boosting economic activity, as the government becomes a large purchaser of goods and services from various parts of the community. Over the coming 10 years, the government proposes an additional $100 billion on infrastructure. $42 billion would be spent in the first four years of that period.

Targeted projects include $500 million for commuter car parks around the country, as part of a $4 billion package to relieve road traffic congestion in our major cities. There will also be rail links for the corridors of fast population growth to the west of Sydney and Melbourne. (Interestingly, while not strictly a budget measure, the government has also announced it will reduce the target rate of permanent migration down from 190,000 people per year to 160,000 people. As we have written elsewhere, population increases have been a major driver in Australia's economic growth over the last 10 years or so. However, the rate of infrastructure development has not kept up with the rate of population growth, leading to the congestion that these budget measures are designed to address).

As a general proposition, Victoria and New South Wales both do well. Victoria will receive an additional $6.2 billion and New South Wales will receive an additional $7.3 billion.

Other Notable Features of the Budget

In the current financial year, the **National Disability Insurance Scheme** will underspend its budget by approximately $1.6 billion. This is because the rollout of the scheme has proceeded more slowly than was expected. The money that has not been spent on the scheme will be 'rolled back' into general government revenue. Many people, such as advocate Kirsten Deane, are criticising this, saying that money that had been initially earmarked for disabled Australians should remain available to that specific sector.

While **regional Australia** will do well from the budget in terms of infrastructure spending, as well as incentive programs designed to encourage people to study at regional universities and colleges, the government aims to reduce the number of overseas-trained doctors coming to Australia each year. As these doctors typically work in regional Australia, it remains to be seen what effect this will have on regional access to medical care.

Summary

In summary, if you did not know that there was going to be an election soon, this Budget would have given you a pretty big hint. It is a budget of mostly good news. All governments like to take credit for a budget surplus, and saving money is usually always a good thing. Most of the Budget's good news will affect people either in their hip pocket (through reduced taxation) or quality-of-life issues such as better infrastructure and reduced travel congestion.

In many ways, you could argue the budget is pretty boring. But when it comes to financial management, boring is usually better!

A Little Bit More About Last Year's Budget

This month's newsletter concentrates on the recent Budget. So, we thought this would be a logical place to discuss a change that was introduced in last year's Budget and that raises a few issues for some clients.

These clients have been receiving some unwanted news when tax time comes for their super fund. They have had an extra tax imposed on contributions to their fund. This tax is known as a 'Division 293 tax.' Division 293 is the relevant section of the *Income Tax Assessment Act* (Cth) of 1997.

Division 293 reduces the tax benefit available for concessional superannuation contributions for people whose relevant income (basically, their taxable income plus contributions) exceeds $250,000. Typically, contributions into super funds are taxed at 15%. This is the case for contributions up to the annual limit for an individual of $25,000. However, where the total of a person's taxable income plus their super contributions exceeds $250,000, the 'excess' contributions into super are taxed at 30%. The way the tax works can be illustrated using three examples.

Jodie has a taxable income of $250,000. She also received concessional contributions into her super fund of $23,750. Her total income for division 293 purposes is $273,750. Ordinarily, the concessional contributions of $23,750 would incur tax of $3562.50. This is 15%. However, because she is above the $250,000 division 293 threshold, her concessional contributions incur tax of 30%. The tax payable within the fund becomes $7125.

Jackie has a taxable income of $240,000. She also received concessional contributions valued at $22,800. Her total income for division 293 purposes is $262,800. This is $12,800 above the $250,000 threshold. As a result, $12,800 worth of her concessional contributions incur tax of 30%. This is $3840. The balance of her superannuation contributions is $10,000 (the total contributions of $22,800 minus the 'excess' $12,800). This $10,000 is only subject to the normal superannuation tax rate of 15%, which equates to $1500. So, the total tax payable by her super fund on the contributions is $5340.

Jackie's example shows that the Division 293 tax only applies to that part of the total relevant income that exceeds $250,000.

Jenny has a taxable income of $230,000. She also received concessional contributions valued at $19,999. Her total income for division 293 purposes is $249,999. This is below the threshold, so she is not subject to division 293 tax. Her superannuation fund only pays the 'normal' 15% tax on the $19,999 of contributions. This equates to $2999.85.

In the case of Jodie and Jackie, their non-superannuation income is taxed at the marginal rate of 47% (including Medicare levy). This is more than both the standard superannuation tax rate of 15% and the division 293 superannuation tax rate of 30%. As a result, they still both pay less tax by receiving income as concessional contributions than they would if they received that income personally. But the division 293 tax reduces the benefit of the super contributions. The contributions are still good, but they are not as good.

Because Jenny has kept her total relevant income below the threshold, she gets the most benefit from her super contributions. If Jenny kept her income low by doing some effective tax planning, then that planning has paid off in spades.

Our message is: people with taxable income around $250,000 will benefit from expert tax and financial planning. Basically, for every dollar by which they reduce their personal taxable income, they save $0.47 in personal income tax. However, because of the way division 293 tax works, if their total relevant income exceeds $250,000, then for every dollar by which they reduce their personal taxable income, they will <u>also</u> save an additional $0.15 in tax through their superfund.

Arguably, the overall marginal tax rate for people affected by division 293 becomes 62% (47% marginal tax rate plus 15% division 293 tax, although this rate is only applied to an amount equivalent to their concessional superannuation contributions, which are capped at $25,000).

Sometimes, division 293 tax 'sneaks up' on people. Our taxable income can exceed $250,000 without us really realising it. Sometimes, the culprit is a one-off taxable receipt, such as a capital gain or an eligible termination payment. Sometimes, our income just grows without us noticing (this can be a particular issue for self-employed people). More likely, people simply do not realise that division 293 tax applies – until they get that first tax bill.

In many ways, earning 'too much' is a nice problem to have. But 62% is a substantial marginal tax rate. So, if you think division 293 might be an issue for you, it is well worth getting expert advice to see what can be done. If this is you, please talk to us. If we can't help you ourselves we will put you in touch with someone who can.

And one last thing to remember: once the tax year is over, is usually too late to do any useful tax planning. June 30 is just around the corner. Act now if you think division 293 is likely to impact you.

The Legal Stuff

General Advice Warning

The above suggestions may not be suitable to you. They contain general advice which does not take into consideration any of your personal circumstances.All strategies and information provided on this website are general advice only.

We recommend you seek personal financial, legal, credit and/or taxation advice prior to acting on anything you see on this website.

Contact Details

Address	119 Willoughby Road Crows Nest NSW 2065
Phone	02 9904 0725
Website	www.alphaadvisers.com.au
Email	cdahiya@alphaadvisers.com.au

Licencing Details

Alpha Advisers Group Pty Ltd ABN 81 056 731 714 is a corporate authorised representative (no. 327545) of Sentry Financial Services Pty Ltd ABN 30 113 531 034 (Australian Financial Service Licence no. 286786).