

30/06/2009

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## Income definition changes

### New Financial Year Tomorrow

It is a good news/bad news story.

The great news is most of us will get extra income due to cuts in the tax rates.

The bad news is we will all pay more for fuel, rates, electricity, and registration of our cars.

The other area of some concern is the new income definitions come into effect.

People who currently have strategies in place such as negative gearing and salary sacrifice and previously qualified for various Government offsets and benefits will now require a change of plan!

Definitions of income which are used to determine eligibility for things such as:

Government Co-contribution

Family Tax Benefit (A and B)

Medicare levy surcharge

Baby bonus

Child care benefit

Child support

Higher Education Loan Programme (HELP)

Pensioner tax offset

Mature age workers tax offset

Senior Australians Tax Offset

Superannuation spouse contributions tax offset

and more are changing from tomorrow. See table below.

**We believe these changes now necessitate a complete re-think of a number of common financial planning strategies.**

*The Tax Laws Amendment (2009 Measures No.1) Act 2009* now expands the definitions of income for various Government eligibility tests to include:

- Reportable superannuation contributions
- Net financial investment losses
- Adjusted fringe benefits.

It's important to note that these changes do not impact the basic taxation of an individual's income. Marginal income tax rates still apply only to taxable income (i.e. excluding salary sacrifice and allowable deductions claimed).

## Salary sacrifice to super

Employers now must identify and report any salary sacrifice amounts paid to staff of the business as “reportable superannuation contributions”.

Reportable employer superannuation contributions will be included on each employee’s Pay As You Go (PAYG) summary from next financial year.

For self-employed and substantially self-employed, personal deductible superannuation contributions will be counted as reportable superannuation contributions under the new income definition.

No Longer will we be able to use salary sacrifice to reduce a person’s taxable income in order to gain greater access to a range of benefits or concessions, which were previously made possible via salary sacrifice:

**Salary sacrifice to superannuation will continue to be valuable strategy for many taxpayers as the primary tax advantage of the strategy has not changed (i.e. paying 15 per cent tax on contributions rather than marginal tax rates).**

### **Increasing/accessing the Government co-contribution**

No longer will salary sacrifice help you to increase the amount you receive for Government co-contributions.

This is where you put in \$1,000 and if you earn under \$31,920 the government will match your contribution. Salary sacrifice will mean there will be many who would have qualified who now do not.

### **What can you do?**

If you wish to increase your retirement savings at the same rate you will have to review your strategy and possibly make your own additional super contributions.

### **Eligibility for personal tax deductions for super contributions – The 10% rule**

Some clients currently use salary sacrifice to reduce employment income to less than 10 per cent of their total income. From 1 July 2009, total income includes reportable employer superannuation contributions and may make those clients ineligible to claim a tax deduction for their personal superannuation contributions.

### **What can you do?**

Not much! Some may do less employed work and focus on self employment activities?

### **Reduction in child support**

Clients who have utilised a salary sacrifice strategy to reduce the amount of child support payable may have their amount payable increased.

### **What can you do?**

Review your cash flow. The calculation of child support is determined based on a number of factors and clients should seek advice based on their own situation.

### **Eligibility for tax offsets**

Amounts salary sacrificed to super will now be included to determine eligibility and entitlement for a number of tax offsets, including the Senior Australians Tax Offset (SATO), Mature Age Workers Tax Offset (MAWTO) and spouse contributions tax offset. As a result, clients may become ineligible for, or receive a reduced amount of, these tax offsets from the 2009/10 financial year.

### **What can you do?**

Again not much! The legislation we mentioned previously which passed in 2008 to provide tax rate cuts, which will take effect in the 2009/10 and 2010/11 financial years, may reduce the impact of these changes for some clients. Likewise, some clients who qualify for these tax offsets may also be eligible for the Low Income Tax Offset (LITO). This income test for LITO is unaffected by these changes.

The threshold amounts and the maximum offset amounts are set to increase over the next two financial years. This too may lessen the impact of the upcoming changes for some clients.

### **Reduction in Government benefits**

The inclusion of salary sacrificed amounts to super will also now be used to determine eligibility for some Government concessions, including the Child Care Benefit and Family Tax Benefit (A and B). Clients currently salary sacrificing into superannuation may find a reduction in their entitlement.

### **What can you do?**

Consider impact on cash flow and plan future expenditure.

### **Social security recipients under Age Pension age**

Those below Age Pension age who now use salary sacrifice to improve their (or their partner's) entitlement to social security benefits, will need to consider how the impending changes will impact on their income support payments once these amounts are included in the Income Test.

### **What can you do?**

You will need to reconsider the amount salary sacrificed to superannuation, if you are unable to meet living expenses following a reduction in income support payments.

The rate of income support payments and thresholds for means testing are indexed on 1 July 2009 and may reduce the impact of their measure. The expanding of the definition of income for social security purposes will impact both support payments and other concessions (e.g. low income health care card).

## Negative gearing

Many people use negative gearing strategies to increase their investment exposure.

But where a client may have previously become eligible for other benefits/concessions as a result, this may no longer be the case once the definition of income is expanded to include both net financial investment losses and net rental property losses. From 1 July, the total investment loss will be included in a client's income for the purposes of some benefits and concessions.

**A net investment loss is the amount by which allowable deductions for particular investments exceed their gross income. It does not include a capital loss.**

This proposal will only affect an individual's eligibility for benefits and concessions. The calculation of an individual's tax liability is unchanged.

Likewise, an investment that provides positive net income or neutral net income is not affected by the change.

Total net investment loss is defined under section 9995-1 of the *Income Tax Assessment Act 1997* as the sum of:

- The amount by which the deductions for an income year that are attributable to financial investments (*as defined in the Social Security Act 1991*) exceeds the gross income from those investments
- The amount by which the deductions for an income year that are attributable to rental property exceed gross income for that year from rental property.

## The following strategies will be impacted by these changes.

### Reduction in child support

Clients who have utilised a negative gearing strategy to invest in financial investments (excluding property) to reduce the amount of child support payable may need to consider the impact on their cash flow if their obligations increase.

### What can you do?

Not much! The calculation of child income support is based on a number of criteria and clients should seek advice on their own situation.

### Eligibility for tax offsets

An income test for a number of tax offsets (e.g. SATO) will include net financial investment losses from 1 July 2009. Clients currently utilising the affected tax offsets may become ineligible from 1 July or receive a reduced tax offset.

### What can you do?

Again not much! As mentioned for salary sacrifice arrangements the legislation which will take effect in the 2009/10 and 2010/11 financial years, may reduce the impact of these changes for some clients.

The threshold amounts and the maximum offset amounts are set to increase over the next two financial years. This too may lessen the impact of the upcoming changes for some clients.

## **Reduction in Government benefits**

The change impacts a range of Government concessions including Child Care Benefit and Family Tax Benefit (A and B). Clients utilising this strategy may find their entitlement reduced and cash flow affected.

## **What can you do?**

Consider impact on cash flow and plan future expenditure.

## **Adjusted fringe benefits**

An expanded definition of income will apply to certain benefits and concessions to include “adjusted fringe benefits” from 1 July 2009.

This means that the non-grossed-up amount of the benefit will be included in income. The increase in the value of fringe benefits will impact on some people’s eligibility for concessions, such as SATO and pensioner tax offset.

## **Summary**

1. Gearing and salary sacrifice strategies continue to be worthwhile strategies.
2. You need to review salary sacrifice arrangements and negative gearing strategies to understand how you will be impacted.
3. These changes do not impact taxation – There will be some adjustment to tax rates though.
4. Fringe benefits need to be reconsidered also.
5. See a quality licensed financial adviser.

## **Disclaimer:**

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## Summary table of affected benefits

<b>Benefit/concession</b>	<b>Inclusion of salary sacrifice amounts to super</b>	<b>Inclusion of net investment and net rental property losses</b>	<b>Adjusted fringe benefits</b>
<b>Government co-contribution</b>			
<b>Pensioner tax offset</b>	X	X	X
<b>MAWTO</b>	X		
<b>Medicare levy surcharge</b>	X	X	
<b>SATO</b>	X	X	X
<b>Superannuation spouse contributions tax offset</b>	X		
<b>Baby bonus</b>	X	X	
<b>Child care benefit</b>	X	X	
<b>Child support</b>	X	X	
<b>Family Tax Benefit (A and B)</b>	X	X	
<b>Higher Education Loan Programme (HELP)</b>	X	X	
<b>Section 160AAB tax rebate for trustees</b>	X	X	X
<b>Student Financial Supplement Scheme (SFSS)</b>	X	X	
<b>Income support for individuals under Age Pension age</b>	X		
<b>Income test residential aged care</b>	X		
<b>Parental income test (Youth allowance, ABSTUDY)</b>	X	X	
<b>Parental income test additional boarding allowance, assistance for isolated children scheme</b>	X	X	