MUTUAL TRUST

2018 Federal Budget Update

Wealth Management Update

Economic Impact

Scott Morrison: 'What have you achieved? What are you going to do now? What does it mean for me?'

Improved Budget Balance

The 2017-18 Budget Deficit will be $18.2 billion, which is half of the deficit of two years ago.

The Budget is forecast to return to a modest balance of $2.2 billion in 2019-20.

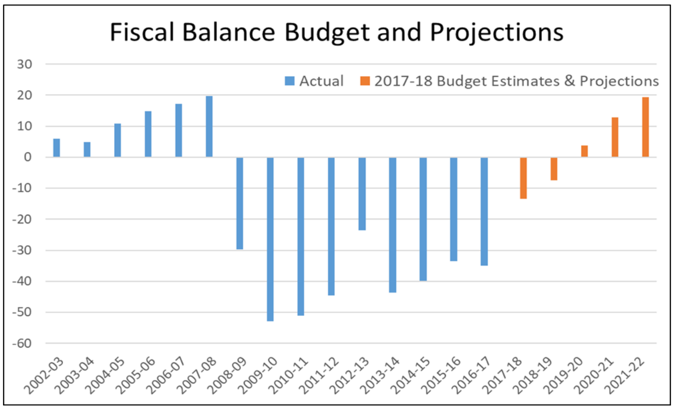
The government has a disciplined real expenditure growth (ie after inflation) which remains below 2%, and falls to 24.7% of GDP. Taxes are being kept under the policy speed limit of 23.9% of GDP.

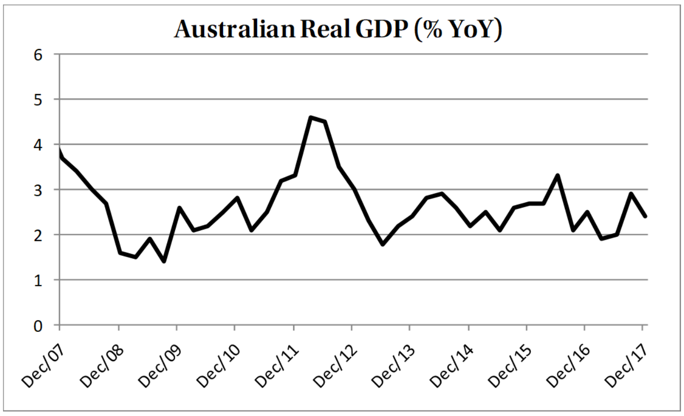
We believe the budget position has a number of risks which the Government has identified and we believe some will have a higher impact than forecast.

Economic Impacts

Our view is that the Government's belief of synchronised global growth continuing in the near term and the GDP, inflation and wage growth forecasts are optimistic. We believe that the future desynchronised growth that the Government projects is apparent now in global Purchasing Manager Indexes.

Australia is the most connected economy to China in the OECD according to RBA Governor Phil Lowe in a recent speech. As China also appears to be slowing as they reform, Australia is more vulnerable to weaker economic outcomes than the Government forecast.





Budget Aggregates	Actual 2016-17	Estimate 2017-18	Estimate 2018-19	Estimate 2019-20	Projection 2020-21	Projection 2021-22
Cash Balance ($bn)	-33.2	-18.2	-14.5	2.2	11.0	16.6
Per cent of GDP	-1.9	-1.0	-0.8	0.1	0.5	0.8
Net Operating Bal ($bn)	-35.0	-13.4	-7.4	-3.7	12.9	19.4
Per cent of GDP	-2.0	-0.7	-0.4	0.2	0.6	0.9
Major Economic Parameters	**Outcomes 2016-17**	**Forecast 2017-18**	**Forecast 2018-19**	**Forecast 2019-20**	**Projection 2020-21**	**Projection 2021-22**
Real GDP	2.1	2.75	3	3	3	3
Employment	1.9	2.75	1.5	1.5	1.25	1.25
Unemployment Rate	5.6	5.5	5.25	5.25	5.25	5
Consumer Price Index	1.9	2	2.25	2.5	2.5	2.5
Wage Price Index	1.9	2.25	2.75	325	3.5	3.5
Nominal GDP	5.9	4.25	3.75	4.75	4.5	4.5

Source: Australian Federal Budget 2018-19

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The path to budget surplus improves

Tax Cuts: Headlines More Important than the Dollars

While any tax cut is a nice perk for consumers, the impact of the headlines may be more important to the economy and investment markets than the actual dollars that will go back in consumers' pockets.

The most immediate changes come in the form of a tax refund to low- and middle-income earners. At most, they amount to "a sandwich and a milkshake" per week for affected consumers and the actual refund won't be received until after the 2019 financial year end.

Changes aimed at protecting taxpayers from "bracket creep" will help higher income earners but won't be enacted until 2023-2025. Besides, by Scott Morrison's own admission, most of these changes will be felt by the 2019-2020 budget year.

The implications for retail spending and consumer cyclical stocks is small.

Retirees (or near-retirees): The Real Winners

Changes announced for those in or nearing retirement may have a meaningfully positive impact on consumer spending by boosting income for some pensioners.

The biggest change is expansion of the Pension Loans Scheme, which allows pensioners to borrow against the value of their home. The program could boost a full pensioners annual income by up to 50% of the Age Pension, or $17,800 for a couple. Employers will be incentive by a $10,000 subsidy to hire aging workers.

Expansion of the Pension Work Bonus will help boost incomes modestly for those still working part-time, while an exemption from the superannuation work test for those with balances <$300k will help add to their retirement savings.

The implications for retail spending from retirees and on consumer cyclical stocks is small.

Ensuring Multinational Corporations pay their "Fair Share"

Multinational Companies who use innovative structures to avoid paying Australian Taxes are being actively targeted to ensure they pay "their fair share". To this end the Government is focussing on the Multinational Anti-Avoidance Law (MAAL) and the Diverted Profits tax (DPT).

While these rules have been a focus since 2016 new initiatives include tightening the rules on stapled securities, strengthening the thin capitalisation rules and tackling hybrid mismatch arrangements.

Infrastructure

The Government is focused on significant infrastructure spending. This budget contains $24.5bn of new nationally significant transport projects, this forms part of a larger 10 year $75bn plan.

The spending has been anticipated for some time so is unlikely to provide a stimulatory effect to the economy over and above that which was already expected. While the spending has been excepted there is some new detail of where the spending is likely to be directed, with the bulk of the spending being focused on Roads, Rail and Airports.

The impact on engineering and development companies has been largely anticipated and we believe is most likely already factored into market prices.

Banking

In the banking sector we expect tightening in regulation continue following the scrutiny of the banking and financial services Royal Commission.

The Australian Financial Complaints Authority will start on 1 November. The Banking Executive Accountability Regime will start on 1 July. The Open Banking Regime and consume data right will further increase competition in the banking industry. We believe that credit growth will likely slow as a result.

Housing is likely to be impacted by the banks' pull back on lending. Fundamentals remain strong, underpinned by strong migration led population growth. Bank stocks are likely to remain under pressure.

For more information, please contact:

GRAEME BIBBY
Chief Investment Officer
P: +61 3 9605 9440
E: graeme.bibby@mutualtrust.com.au

PAUL HOCKRIDGE
Partner – Tax Advisory
P: +61 3 9605 9546
E: paul.hockridge@mutualtrust.com.au

Tax Update

Personal income tax rates

The seven year plan is to have three steps. First, there is to be a tax offset of up to $530 for low and middle-income taxpayers for the 2018-19 to 2021-22 years inclusive. It will be paid when your assessment issues.

The savings are to be made up of:

– $200 for taxpayers whose taxable income is up to $37,000
– If your taxable income is between $37,000 and $48,000 you get an extra 3 cents per dollar of taxable income to a maximum of $530
– If your taxable income is between $48,000 and $90,00 you will be entitled to $530
– If your taxable income is between $90,001 and $125,333, the offset reduces by 1.5 cents per dollar.

In step 2 from 1 July 2018, the 32.5% personal income tax threshold is to increase from $87,000 to $90,000

From 1 July 2022, the low income tax offset is to be increased and the 32.5% threshold is to be increased from $90,000 to $120,000

In step 3, the 37% bracket (which currently applies between $87,001 and $180,000) is to be removed from 1 July 2024, at which time the $180,000 threshold will increase to $200,000.

$20,000 instant asset write-off

The ability of businesses with an aggregate annual turnover of less than $10,000,000 to immediately write-off asset purchases costing less than $20,000 is to be extended to 30 June 2019.

Reporting payments to contractors

The system for reporting (to the ATO) payments to contractors in some industries (like wages are reported to the ATO) is to be expanded. It will apply to payments from 1 July 2019. The first report will be due in August 2020. It will apply to:

– Security providers and investigation services
– Road freight transport
– Computer system design and related services

$10,000 cap on cash payments

From 1 July 2019 there is to be a limit of $10,000 for cash payments made to businesses for goods and services.

Withhold, get an ABN or lose your deduction

From 1 July 2019, if you fail to deduct PAYG from payments to employees or to contractors who do not provide an ABN, you will not be entitled to claim a deduction for the payments.

Managed Investment Trusts

From 1 January 2019, residents of 56 jurisdictions that have information sharing agreements with Australia will be eligible for a reduced withholding tax rate of 15% (rather than 30%) on certain distributions from Australian Managed Investment Trusts (MIT's).

MIT's and Attribution MIT's will not be able to apply the 50% CGT discount from 1 July 2019. However, the CGT discount will be able to be claimed by Australian resident investors (but not non-resident) who receive distributions.

Significant Global Entities (SGE's)

The definition of SGE is to be expanded from 1 July 2018 to include private (as well as public) groups. This will subject them to legislation such as the Multinational Anti-Avoidance Law and the Diverted Profits Tax. Broadly, these rules might apply where annual group turnover is $1 billion or more.

Phoenixing

The corporations and tax laws are to be extended to combat phoenixing. In particular, the Director Penalty Notice (DPN) regime is to be extended to include a company's GST (and luxury car tax and wine equalisation tax) liability. The DPN regime makes directors personally liable for a company's tax debts.

Division 7A – unpaid present entitlement (UPE's)

UPE's to trust income owing to private companies are to be subject to Division 7A (the deemed dividend rules) from 1 July 2019, if they are not already. It is not yet clear how or whether this extends the existing law.

Everett Assignments

From Budget night, partners who assign an interest in their (large) partnership to a related party, typically referred to as an Everett assignment, will no longer be able to obtain access to the CGT small business concessions.

Circular trust distributions

From 1 July 2019, an anti-avoidance rule will apply to family trusts to prevent them avoiding tax by distributing income in a "round robin" arrangement, where the distribution can be returned to the original trustee with no tax payable.

Testamentary Trusts

From 1 July 2019, the concessional tax treatment of minors will be limited to income derived from assets transferred from a deceased estate or the proceeds on disposal of such assets.

Superannuation contributions

From 1 July 2019, people aged 65 to 74 with superannuation balances below $300,000 will be eligible to make

superannuation contributions without having to meet the work test. The work test requires an individual to have worked at least 40 hours within 30 consecutive days in a financial year. This concession will allow a person having a balance less than $300,000 to contribute an after-tax lump sum of $300,000 (using the bring forward rule) in the first year that they do not meet the work test.

Self-managed funds: three yearly audit requirement

From 1 July 2019, self-managed funds with good compliance histories will only require a three-yearly, instead of annual, audit.

Other super issues

The supervisory levies imposed on funds will increase as the government moves to recover the full cost of industry supervision.

There will be a three percent annual cap on passive fees charged on accounts with balances below $6,000, from 1 July 2019. Exit fees will be banned on all superannuation accounts.

Inactive accounts will be transferred to the ATO, which will expand its data matching processes to reunite these accounts with the member's active account.

From 1 July 2019, the current default insurance arrangements applying to certain superannuation members will change to an opt-in arrangement, impacting young members, low balance or inactive accounts.

ATO will have greater power in checking deductions claimed for personal superannuation contributions against super fund records.

Superannuation guarantee contributions

From 1 July 2018, individuals with income in excess of $263,157 with multiple employers will be able to nominate that their wages from certain employers are not subject to superannuation guarantee contributions, allowing them to avoid unintentional breaches of the $25,000 contribution cap.

Image rights

Sportspersons, media personalities and entertainers sometimes licence related entities to use their image or likeness. This might shift some of their income to say a family trust. From 1 July 2019, such income will be taxed to the individual.

Property Holdings

From 1 July 2019, deductions for expenses associated with holding vacant land, e.g. interest, are to be denied, where the land is not held for the purpose of earning assessable income.

Denied deductions will not be able to be carried forward for use in later years. They might however form part of the cost base of the land for CGT purposes.

This measure will not apply to expenses incurred after a building has been constructed and occupancy approval has been granted and it is available for rent, or if it is used by the owner to carry on a business.

Although the announcement leaves much unanswered, it might be that these rules will not apply to commercial developments where a business of development is carried on.

Of considerable concern is the proposed tax treatment of activities which are subject to income tax as profit making undertakings but not businesses, as they might be denied deductions unfairly. We will monitor developments.

Research and Development (R&D)

From 1 July 2018, for companies with aggregated turnover of $20 million or more, the cap on expenditure eligible for R&D tax offsets is to increase from $100 million to $150 million. By way of background, under the current rules, assume a tax offset of 38.5 cents but no deduction, for each $1.00 of eligible R&D expenditure.

Under the new rules the "premium" above the corporate tax rate will increase as the proportion of R&D expenditure to total expenditure increases. This is called incremental intensity and the premium could be in the range of 4% to 12.5%.

For companies with less than $20 million turnover, the premium will be 13.5% above the company's tax rate. Refundable offsets will be capped at $4 million and any excess can be carried forward.

MUTUAL TRUST

info@mutualtrust.com.au
mutualtrust.com.au

ABN 71 004 285 330
AFSL 234590

Level 32
360 Collins Street
Melbourne VIC 3000

T +61 3 9605 9500

Suite 12, Level 1
40 St Quentin Avenue
Claremont WA 6010

T +61 8 9230 7700

Level 30
9 Castlereagh Street
Sydney NSW 2000

T +61 2 9224 7600