

Budget Update

2011/2012 Federal Budget

Commentary

The Treasurer flagged that the Budget needed to contain some pain to bring the budget to surplus by 2012-13. Unsurprisingly, there are no tax cuts and not much for business.

It is interesting to note that the rhetoric has changed. We are no longer in a two speed economy but rather a patchwork economy. According to Mr Swan, we are about to participate in an investment boom. Perhaps it is a pity that not too many can see it coming.

However, he acknowledged that small business is perhaps doing it a little tough and announced measures including a reduction in the PAYG instalment uplift factor and the \$5,000 immediate vehicle write off (although this does not take place until the 2012-13 year).

In terms of headline figures, real GDP growth is expected to be 4% in 2011-12 and 3.75% in 2012-13. The forecast deficit for 2011-12 is \$22.6 billion with the budget to return to surplus forecast at \$3.5 billion for 2012-13. The jobless rate is expected to be 4.75% at June 2012 and 4.5% at June 2013. The Treasurer spoke at length about training and participation in the workforce.

He announced \$22 billion of so called pain over five years with approximately two thirds of this represented by spending cuts.

Some of the tax measures that were leaked prior to Budget night include the following:

- progressive changes to a flat 20% statutory fraction rate for FBT on cars;
- removal of the low income tax offset for unearned income of minors; and
- amendments to ensure access to losses on infrastructure investments.

A couple of proposed amendments can probably be categorised in the mean spirited box. There will be a potential to refund excess superannuation contributions but only up to an amount of \$10,000 and only where the excess contribution arises from 1 July 2011. The other area is a crack down on the commercial activities of charities and also the introduction of a common definition of charity. This may well see some current charities losing that status.

The Government has highlighted the following key expenditure:

- \$558 million for the national workforce development fund.
- additional funding for health including expanding access to diagnostic imaging services, improving access to public dental services and \$1.5 billion in new initiatives to address mental illness.

In addition new investment in schools amounts to over \$800 million and approximately \$230 million has been allocated to new strategic investments to develop regional Australia.

1 Personal Income Tax

The Government announced that they were not making any changes to the current personal income tax rates other than to add the previously announced flood levy for one year commencing 1 July 2011.

The flood levy was announced after the Queensland and Victoria floods earlier this year and is expected to raise \$1.8 billion to assist with the reconstruction efforts in those states. The levy was introduced into Parliament on 10 February 2011 and passed both houses of Parliament in March.

The levy is to be calculated as follows:

Taxable Income (\$)	Flood Levy
0 – 50,000	Nil
50,000 – 100,000	0.5% of amount exceeding \$50,000
100,000 +	\$250 + 1% of amount exceeding \$100,000

The following table outlines the resultant tax rates applicable to resident taxpayers for the 2011-12 financial year when compared to current personal income tax rates (excluding Medicare):

Current personal income tax rates*		2011-12 personal income tax rates	
Taxable Income (\$)	Rate (%)	Taxable income (\$)	Rate (%)
0- 6,000	0	0- 6,000	0
6,001 – 37,000	15	6,001 – 37000	15
37,001 – 80,000	30	37,000 – 50,000	30
		50,001 – 80,000	30.5
		80,001 – 100,000	37.5
		100,001 – 180,000	38
180,001 +	45	180,001	46

* Also applies post 1 July for exempt taxpayers, i.e. those that have received an Australian Government Disaster Recovery Payment.

Low Income Tax Offset removed from unearned income of minors

In another measure announced prior to the release of the budget, the Government will remove the ability of children under the age of 18 to access the low income tax offset ("LITO"). This offset has previously reduced the tax payable by minors on their unearned income such as dividends, interest, rent, etc. This measure is specifically targeted at

discouraging distributions of income to children from discretionary trusts.

In the 2010-11 year minors have been able to receive up to \$3,333 of income without being subject to income tax due to the operation of the LITO. With the introduction of this measure effective from 1 July 2011, minors will only be able to receive \$416 of unearned income before they commence paying tax.

Other changes to Personal Rebates and Offsets

The Government also announced changes effective from 1 July 2011 that will provide additional cash to low income earners through an increase in the amount of the Low Income Tax Offset that is delivered via decreased tax withheld from salary rather than through a rebate on their annual income tax return. A taxpayer with an annual income of \$30,000 will receive an additional \$300 during the year through lower income tax instalments being deducted from their salary payments.

As part of the Government's measures to increase the participation rate of the workforce, the Government announced that commencing 1 July 2011 it would phase out the Dependent Spouse Tax Offset beginning with offsets paid to those with partners under the age of 40. Importantly, dependent spouses with children are not impacted by this phase out as they receive Family Tax Benefit B rather than the Dependant Spouse Tax Offset.

No more deductions against Government assistance payments

From 1 July 2011, an individual taxpayer will no longer be able to claim work-related expenses as deductions where income is derived only in the form of Government assistance payments.

Further to their press release of 17 December 2010, the Government will amend the tax law to prevent deductions being claimed against all government assistance payments.

From this date, this proposed legislative amendment therefore negates the effect of the 2010 High Court decision of *Commissioner of Taxation v Anstis* where it was held that a student could claim a deduction for study expenses even though the student only received Youth Allowance while studying full-time.

However, the Commissioner will still allow eligible taxpayers to receive an automatic deduction of \$550 or a higher amount if it can be substantiated in respect of the 2007 to 2011 income tax years.

Medicare levy threshold increases

From 1 July 2010, the Medicare levy low income thresholds will be retrospectively increased to \$18,839 for individuals, \$31,789 for families, \$2,919 for each dependent child or student and \$30,439 for single pensioners below Age Pension age.

Reduction in HECS discounts

From 1 January 2012, there will be a reduction of benefits for taxpayers involved in the Higher Education Contribution Scheme (HECS) in that if students elect to pay their student contribution up-front, they will only receive a 10% discount (instead of the current 20% discount). If students do not pay their student contributions up-front, they will accrue the outstanding debt and only receive a 5% bonus (instead of the current 10% bonus) on any payments of \$500 or more towards the debt.

Pacific Seasonal Worker Pilot Scheme

From 1 July 2011, the marginal tax rate of non-resident individuals participating in the Pacific Seasonal Worker Pilot Scheme who earns less than \$37,001 per year will be reduced to 15% (currently the rate is 29%).

Workers qualifying for this rate will not have access to the tax free threshold or low income tax offset.

2 PAY AS YOU GO (PAYG) INSTALMENTS TAXPAYERS

From 1 July 2011, entities that use the GDP adjustment factor method to work out their quarterly PAYG tax instalments will have to remit less income tax instalments from the 2012 income tax year onwards.

By way of background, the GDP adjustment factor for PAYG instalment taxpayers increases the previous year's adjusted taxable income by the previous year's nominal GDP growth to determine the amount of the tax instalments to be paid in the income tax year.

The GDP adjustment factor will be reduced from 8% to 4% from that date. According to the Government, this reduction will lead to significant cash flow benefits.

3 SMALL BUSINESS TAX CHANGES

Small Business CGT concessions

The Government announced changes that will effect eligibility to the small business CGT concessions for CGT events happening after 7:30pm (AEST) on 10 May 2011.

The changes are designed to ensure that trusts will not be able to avoid being treated as connected entities for the purposes of testing eligibility for the CGT small business concessions.

There have been arguments in the past that as trusts do not own assets for their own benefit, the value of assets held in trusts do not need to be taken into account when testing eligibility under the relevant thresholds for the small business CGT concessions.

The budget papers suggest that the changes will also ensure that assets held by some small businesses that have not qualified previously will now be active assets for the purposes of the concessions.

Entrepreneurs Tax Offset replaced with Small Business “Instant” Write-Off for Motor Vehicles

The Government will introduce a tax write-off for the first \$5,000 of any motor vehicle purchased by a small business from 1 July 2012. The write-off replaces the Entrepreneurs Tax Offset (ETO) incentive arrangements. The new measure will provide the following:

- An “instant” write-off of the first \$5,000 of the purchase value of any motor vehicle;
- The ability to transfer the balance of the purchase value to the general small business depreciation pool (15% depreciation in year 1; 30% depreciation in subsequent years).

The Treasurer's Press Release on the measure states that the write-off is available to all small businesses. Eligible small business entities will include sole traders, trusts, partnerships and companies.

4 CAPITAL GAINS TAX

Amendments to capital gains tax (CGT) scrip for scrip roll-over

Integrity provisions currently apply in respect of the scrip for scrip roll-over measures for shareholders with sufficient interests to potentially influence both the target and acquiring entity in a restructure. Where the integrity provisions apply, the cost base in the target entity that is acquired is inherited from the original shareholder.

Some trusts, superannuation funds and life insurance companies have considered that these integrity provisions do not apply to them because they own the interests for the benefit of others (i.e. the beneficiaries) rather than for their own benefit. The amendments will make it clear that this was never the intended interpretation of the integrity provisions.

The amendments will ensure that the integrity provisions also appropriately apply to stakeholders that are trusts, superannuation funds and life insurance companies in respect of capital gains tax (CGT) events that occur after 7:30pm (AEST) on 10 May 2011.

CGT exemption relating to renewable resources or preserving environmental benefits

Gains or losses arising from a right to a financial incentive granted to taxpayers under an Australian Government (Commonwealth, State or Territory) scheme that encourages the acquisition of renewable resource assets, or for their agreement to preserve a part of Australia's environmental amenity, will be exempted from CGT.

Examples of renewable resources assets include photovoltaic solar cells or solar hot water systems. An example of preserving Australia's environmental amenity is refraining from removing remnant vegetation. This measure

will also turn off the income tax recoupment rules in relation to any underlying assets (e.g. solar hot water systems) to ensure that the incentive keeps its full financial value. This measure will apply to income tax assessments for the 2008 income year and later.

CGT- minor amendments to ensure the proper functioning of the provisions

Minor amendments will be made to ensure the proper functioning of the CGT and associated provisions. The changes will include:

- Ensuring that the roll-over for the exchange of shares in one company for share in another company operate to defer the profit or loss where the original shares are held on revenue account at the time of the exchange. This change will have effect from 7:30pm (AEST) on 10 May 2011.
- Amending the roll-over for certain disposals of assets by a trust to allow roll-over relief to apply where a transferee company or trust holds rights, just before the disposal or transfer time, associated with a deed or similar document that is designed to facilitate the transfer of assets into the company or trust. The changes to the roll-over for the disposal of assets by a trust to a company will have effect for CGT events happening after 7:30pm (AEST) on 10 May 2011 and the changes for the transfer of assets between certain trusts will have retrospective effect for CGT events happening on or after 1 November 2008.
- Ensuring that gains and losses arising from life insurance policies that are generally exempted from CGT are not then taxed under the ordinary income tax provisions. These changes will apply to CGT events happening in the 2006 income year and later.
- Legislating the current Tax Office administrative practice of allowing a testamentary trust to distribute an asset of the deceased person without a CGT taxing point occurring. The income tax law in relation to deceased assets will also be rewritten using a principle based format. These changes will apply to CGT events happening after the legislation receives Royal Assent.

5 COMPANY LOSS RECOUPMENT RULES

The company loss recoupment rules are to be amended with effect from the 2011-12 income year to make it easier for companies to satisfy the continuity of ownership test in certain circumstances. The rules will be modified so that ownership does not need to be traced through certain superannuation entities.

Furthermore, the proposed changes will remove technical deficiencies in the modified rules for widely held entities where:

- an entity is interposed between certain stakeholders and the loss company in certain circumstances;
- an interposed entity demerges;

- an interposed foreign entity issues bearer depository receipts; or
- a corporate change arising from the issue of new shares happens.

The measure will also ensure that all membership interests held in an entity are treated as a single asset for the purpose of applying the low value asset exclusions under the loss integrity rules.

6 DEBT/EQUITY TAX RULES

Under the income tax rules, returns on debt interests (e.g. interest) are a pre-tax expense and deductible. On the other hand, returns on equity interests (e.g. dividends) are non-deductible (although they may be frankable).

Section 974-80 of the Income Tax Assessment Act 1997 was introduced in July 2001 as an integrity provision to ensure that an equity interest could not be disguised as a debt interest - i.e. where the debt interest in the issuing company was used to fund equity returns to an ultimate investor through related entities.

The Government was originally concerned that a company could obtain tax benefits associated with issuing debt interests, by interposing related party entities between itself and an investor, whereby debt instruments would be issued to those interposed entities. This strategy would create artificial deductions to the issuer company, where the ultimate investor would hold an equity interest in the interposed entity.

The Government originally intended that the integrity provision would only apply in limited circumstances where an ultimate investor had an "effective equity interest" in the relevant company (through the interposed entities). However, the wording of the integrity provision is currently broadly drafted and the Australian Taxation Office ("ATO") has previously issued a discussion paper outlining a view that the provisions could apply well beyond the original policy intent to ordinary funding transactions.

The Government has announced in the Budget that it will amend the integrity provision to limit its scope and to ensure that the provision will only apply to arrangements where both the purpose and effect is that the ultimate investor has, in substance, an equity interest in the issuer company. In addition, the provision will be amended to give the ATO a discretion not to apply the section where it would be unreasonable for the provision to apply. The change will be retrospective with effect from 1 July 2001 (being the date of commencement of the debt/equity tax rules).

It is noted that the ATO has recently been targeting certain funding arrangements of stapled structures using the current drafting of the integrity provision. The announcement is silent as to whether the proposed retrospective amendments will change the ATO's approach in respect of audits and reviews being conducted in relation to these types of funding arrangements.

7 TAXATION OF FINANCIAL ARRANGEMENTS

A number of important amendments were announced in relation to the Taxation of Financial Arrangement provisions, including important changes to the tax hedging provisions as well as an announced extension of the functional currency provisions to certain trusts and partnerships.

Tax hedging

Under the tax hedging provisions contained in TOFA, a gain or loss on a hedging instrument for tax purposes can be matched against a gain or loss on the hedged item. Under the current rules, where the hedge is effective (within the accounting 80% to 125% threshold), the whole gain or loss on the hedging instrument is taken to be 100% effective for tax purposes. Accordingly the whole gain or loss can be deferred and matched against the underlying hedged item. This differs to the accounting rules, which only allow matching of the effective portion. For taxpayers who are not interested in aligning tax with their accounts and are interested in tax hedging strategies, this outcome provides an appropriate tax result.

The Government has announced a slight change to the effectiveness rules (retrospective to the start of the TOFA provisions); so that the ineffectiveness of a hedge for tax purposes will follow the accounting treatment only if the taxpayer also makes a financial reports election. We are glad that this announcement is limited, as it will have no impact on those taxpayers seeking to obtain a fully effective tax hedge, especially where that taxpayer is not interested in aligning their tax position to the accounting profit or loss amounts.

A minor technical amendment was also announced to ensure that the tax hedging rules apply appropriately to hedges of firm commitments (especially where the hedged item is different for tax and accounting purposes). This amendment has been due to the ATO taking a view that a hedge of trading stock did not work properly for tax purposes. The package of reforms also restated pre-announced extensions of time to comply with the tax hedging documentation requirements (where the accounting requirements are already satisfied) and the introduction of a Commissioner's discretion to accept the late lodgement of transitional elections

Functional currency election

The Government also announced its long awaited extension of the functional currency provisions to certain trusts and partnerships. The functional currency provisions allows certain entities (that prepare their accounts predominantly in a foreign currency) to elect to use that foreign currency in calculating their Australian taxable income and tax liability. For example, if a qualifying taxpayer prepares its accounts in US dollars, it can choose to calculate its taxable income in US dollars and convert the single amount at year end to Australian dollars.

The election helps to simplify the calculation of foreign exchange gains and losses in the entity for any income year. The election also avoids the crystallisation of gains and losses in the entity for amounts held in that functional currency and can therefore provide an appropriate hedging strategy at an entity level.

While the announcement is positive, it is stated to be limited to "certain" trusts and partnerships. The announcement follows submissions requesting an extension of the functional currency rules to foreign hybrid partnerships, controlled foreign trusts and Australia resident trusts required to prepare accounts under the Corporations Act. In our view, it would be unfortunate if this measure were limited only to those types of entities and are not extended to closely held entities in the middle market space. The measure will only apply prospectively from the date of Royal Assent.

8 MANAGED INVESTMENT TRUSTS

Investment manager regime – interim arrangements extended

The US accounting standard FIN 48 (FASB ASC 740-10) requires uncertain tax positions to be disclosed in the relevant accounts. Ordinarily, the uncertainty of many of the Australian taxation provisions would have caused significant concerns for offshore fund managers required to prepare accounts in accordance with these standards, which may have discouraged foreign investment into Australia.

In order to provide certainty to such offshore fund managers investing in Australia, the Government previously announced that where a foreign managed fund had not lodged a tax return for the 2009-10 or prior income years in respect of certain investment income of the fund, the ATO would not be permitted to raise an assessment in respect of that income. These interim arrangements will now be extended to include the 2010-11 income year in order to provide further certainty in relation to the preparation of accounts for that financial year.

Also as previously announced on 19 January 2011, the Government will amend the tax law to exempt income from relevant investments in a foreign managed fund where it is taken to have a permanent establishment because of an Australian intermediary that is a dependant agent, branch or subsidiary of a foreign fund. The change is proposed to apply from the 2010-11 income year.

New Tax system for MITs

As previously announced on 8 April 2011, the Government will defer the start date for the new tax system for MITs to 1 July 2012 and make two minor (but important) changes to the new tax systems for MITs.

First, the tax law will be amended to allow MITs to make amendments to their trust deeds to comply with the "clearly defined rights" requirement without triggering a trust resettlement. Secondly, the proposed *de minimis* rule allowing MITs to carry forward under and over distributions

to the next income year (without adverse tax consequences) will be amended by replacing the alternative test of the *de minimis* threshold of a 'prescribed dollar value per unit' with a '0.4 of 1 per cent of net assets' test.

Fund payment withholding tax

The trustee of a managed investment trust is required to withhold tax from 'fund payments' made to foreign resident investors. A fund payment is so much of the net income of the trust for that year as is not a dividend, interest or a royalty (which are subject to their own withholding arrangements), a capital gain or capital loss from a CGT event that happens in relation to a CGT asset that is not taxable Australian property, and amounts that are not from an Australian source.

The withholding rate is 7.5% for fund payments in relation to the 2010-11 and later income years where the investor is resident in a limited list of information exchange countries and 30% for other foreign investors.

The Government has announced that the list of information exchange countries will be updated to include Belize, the Cayman Islands, the Commonwealth of the Bahamas, the Principality of Monaco, the Republic of San Marino, the Republic of Singapore, St Christopher and Nevis, and St Vincent and the Grenadines.

It is particularly pleasing to see Singapore added to this list given that Singapore has the third largest pool of funds under management in Asia and has the sixth largest globally.

9 GOODS AND SERVICES TAX

Further deferral of Board of Taxation recommendations

The implementation of a number of Board of Taxation recommendations that were to commence from 1 July 2011 will now be deferred.

The deferral applies to the following recommendations:

- Adopting the income tax self assessment regime for indirect taxes;
- Reforming the rules that govern change of use adjustments;
- Allowing adjustments for pre-registration acquisitions;
- Clarifying the treatment of tax law partnerships;
- Simplifying the GST grouping membership rules and allowing grouping of non-operating holding companies and trusts;
- Amending indirect tax sharing agreement provisions, and
- Introducing a reverse charge for supplies of going concerns and farm land.

The revised start date for these measures will now be the first quarterly tax period after the amending legislation receives Royal Assent, or, if more appropriate, a later quarterly tax period after Royal Assent.

According to the Budget papers, the deferral will allow additional time for the development of these measures in consultation with relevant stakeholders.

The Government will also not proceed at this stage with the 2009-10 Budget measure to provide an option to treat certain business to business supplies as taxable.

Treatment of new residential premises

In *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46, the Full Federal Court held that the sale by a developer of newly constructed premises that had been subject to a development lease arrangement was an input taxed supply of residential premises that was not subject to GST when sold to home buyers and investors.

To overcome the decision in this case, the Government will introduce amendments designed to ensure that:

- From 3 October 2007, the sale of newly constructed residential premises under development lease arrangements will be treated as a taxable supply of new residential premises;
- From 1 July 2000, the granting of individual strata lot leases over newly constructed residential premises will not be sufficient in itself to make future supplies of the premises input taxed; and
- From 1 July 2000, any change in property title arrangements will not result in the premises once again becoming new residential premises.

Transitional arrangements will apply to ensure that taxpayers who entered into arrangements on the basis of the Gloxinia decision will not be disadvantaged by the amendments provided the arrangements were entered into prior to 27 January 2011, which was the date the Government first announced the proposed amendments.

Sale of property mortgagees in possession

Mortgagees in possession that sell property in satisfaction of an existing debt are required to account for GST on the sale if the sale of the property by the debtor would have been a taxable supply.

In some circumstances, the mortgagees in possession may also qualify as representatives of incapacitated entities, which are governed by a distinct set of rules under the GST law that require the representative to obtain a separate GST registration in their capacity as a representative of the incapacitated entity.

The Government will amend the law to ensure that entities in the mortgage lending sector can continue to use their existing GST registration to report obligations in relation to sales of property as mortgagees in possession, rather than

needing to obtain a new GST registration. This measure will take effect from 1 July 2012.

Extending the GST instalment system to entities in a net refund position

Currently, the GST Act allows small businesses to meet their GST reporting and payment obligations by electing to pay GST by instalments on a quarterly basis with an annual reconciliation, usually at the time of lodgement of the entity's income tax return.

However, the ability to make the election is currently denied if the entity is in a net refund position, which is generally where the entity's input tax credit entitlements exceed its GST liabilities in the 12 months preceding the current tax period that applies to the entity.

The GST instalment system rules will be amended to allow small businesses in a net refund position to choose to access the instalment system, with an instalment amount each quarter of zero. Any liability payable by the entity or refund owing to the entity will be reconciled in their annual GST return. This measure will apply from Royal Assent.

10 FRINGE BENEFITS TAX

Over the next four years the Government will progressively replace the current statutory formula method of calculating the taxable value of a car fringe benefit with a single statutory rate of 20% to be applied regardless of the number of kilometres travelled in a year, as follows:

Distance travelled during the FBT year (1 April – 31 March)	Statutory rate (multiplied by the cost of the car to determine a person's car fringe benefit)				
	Existing contracts	New contracts entered into after 7.30pm (AEST) on 10 May 2011			
		From 10 May 2011	From 1 April 2012	From 1 April 2013	From 1 April 2014
0 -15,000 km	0.26	0.20	0.20	0.20	0.20
15,000 – 25,000 km	0.20	0.20	0.20	0.20	0.20
25,000 – 40,000 km	0.11	0.14	0.17	0.20	0.20
More than 40,000 km	0.07	0.10	0.13	0.17	0.20

Employers will still be able to use the operating cost (or 'log book') method for valuing car fringe benefits as an alternative to the statutory formula method.

11 SUPERANNUATION

Refund of excess concessional super contributions

Eligible individuals will be provided with a one off option to have excess concessional contributions refunded from their super fund and assessed as income at marginal rates instead of incurring excess contributions tax (which is applied at an effective flat rate of 46.5%).

The one off refund option will be available if an individual has made excess concessional contributions of no more than \$10,000 in a year commencing from 1 July 2011.

The measure will help fix small one off inadvertent errors where excess contributions tax would currently apply but does nothing to address the longer term design flaws in the current system. This is particularly disappointing given the strong and consistent message from industry that excess contributions tax was the number one priority for the Government to address in super.

Reduction in the minimum payment amounts for account-based pensions in 2011-12

The Government has announced that for the 2011-12 year individuals receiving an account based super pension will be required to draw 75% of the standard minimum pension. This is an increase from 2010-11 year where 50% of the standard minimum pensions was required to be drawn.

The full standard minimum pension will be required to be drawn in 2012-13 and subsequent years.

Reporting super on payslips

Employers will be required to report information on employee payslips about the amount of super contributions actually paid into the employee's super account. The reporting requirement will commence from 1 July 2012.

The measure appears to be reinstating reporting requirements that applied up until 1 January 2005.

In addition, employees and employers will receive quarterly notification from their superannuation fund if regular contributions cease after 30 June 2012.

Over 50s and \$50,000 concessional contribution cap

The Government has confirmed its intention to allow taxpayers of the age of 50 years or more to retain a \$50,000 concessional contribution cap if they have less than \$500,000 accumulated superannuation entitlements.

The current transitional concessional contribution cap of \$50,000 will cease to apply from 30 June 2012 and revert to the standard cap of \$25,000.

From 1 July 2012, a higher concessional contribution cap may continue to be available depending on the individual's

age and the amount of their superannuation entitlements. The Government has not provided details on how the scheme will be administered.

Self Managed Super Funds

The Government is increasing the annual levy by \$30 to \$180 a year for each self managed fund payable on lodgement of the fund's 2010-11 return. The \$50 million raised over forward estimates will be used for a range of measures including:

- Introducing administrative penalties the ATO can apply in cases of non-compliance by trustees
- Tightening legislative restrictions for investments in collectables and personal use assets (applying to new investments from 1 July 2011)
- Requiring funds to value their assets at net market value
- Introducing knowledge and competency requirements on service providers

Most changes are stated to commence from 1 July 2012 and have previously been announced.

Government funds the development of MySuper

The Government has provided funding to APRA and ASIC to implement "MySuper", a simple low cost default superannuation product for large superannuation funds.

The measure will be funded by an increase in the annual levy on APRA regulated funds. The Government expects to provide funding for this measure beyond 2015.

Co-contribution threshold

The Government will not index the thresholds governing eligibility for the co-contribution. The co-contribution phases out when individuals earn more than \$31,920. This means more people will cease to be eligible for a co-contribution and the Government's expenditure on co-contributions will fall.

SMSF Auditor registration is coming

The Government has announced a raft of measures aimed at improving the efficiency and effectiveness of the SMSF sector. Among these measures will be knowledge and competency requirements for SMSF auditors.

From 1 July 2012 SMSF auditors will need to be registered with ASIC and will be required to pay an, as yet unspecified, annual registration fee. ASIC will develop an online SMSF auditor registration process.

12 NON FOR PROFIT SECTOR REFORMS

Significant changes relating to eligibility for tax concessions were announced, together with new administrative arrangements, in the Not-For-Profit ("NFP") sector.

The suite of measures includes:

- Removing tax concessional treatment for commercial activities conducted by charities where the commercial activities are "unrelated" to the altruistic purposes of those charities;
- Introducing a statutory definition of "charity" to be used across all Commonwealth agencies from 1 July 2013; and
- The establishment of a new Australian Charities and Not-for profits Commission ("ACNC") to regulate the NFP sector.

The establishment of the ACNC is forecast to generate revenue of \$41m over the four years to 2014-15. One of the ACNC's roles will be to "re-assess the charitable status of entities on the basis of the new statutory definition".

Under the existing law, provided an entity qualifies as a charity all of its profits are exempt from income tax.

The new rules will limit tax concessional treatment for profits from commercial activities that are "unrelated" to the charity's (or other NFP's) altruistic purpose to profits that are directed back to the entity to carry out its altruistic work. Profits retained in the commercial operation will be subject to income tax.

Other tax concessions, including FBT, GST, or deductible gift recipient status, will be similarly limited.

There will be exceptions for "small scale and low-risk" unrelated commercial activities conducted by a NFP entity.

The new rules will apply from 1 July 2011, subject to transitional measures that will be negotiated for existing unrelated commercial activities.

Whilst the ATO will continue to administer the tax concessions for NFPs, the ACNC will be responsible for determining the eligibility for those concessions from the time of its commencement on 1 July 2012.

13 TAX COMPLIANCE – IMPROVEMENT MEASURES

The Government has announced various measures to improve tax compliance across various aspects of the economy. The following measures are expected to result in over \$1 billion in additional revenue.

Countering fraudulent phoenix activities by company directors

The government has announced changes seeking to reduce the prevalence of "Phoenix" activity by arming the ATO with some significant additional recovery weapons. Phoenix activity refers broadly to the practice of collapsing or liquidating a business in one entity, only to recommence the same business in another entity the next day. The creditors (most usually including the ATO) are left behind in the defunct entity.

The proposed changes, which will become effective from 1 July 2011, are:

1. Extending the application of Directors Penalty Notices (DPNs) to apply to superannuation guarantee amounts. A DPN is a notice issued to the directors of a company requiring payment of certain taxation liabilities, most notably PAYG deductions, within 21 days. Failure to pay the amount within that 21 days or place the company into Liquidation or Administration within that time renders the directors liable for a penalty equal to the unpaid tax.
2. Personal liability for company directors for unpaid employee superannuation payments.
3. Prevention of directors or their associates from claiming the benefit of tax withheld unless those amounts have actually been remitted to the ATO.
4. Automatic personal liability for certain taxes that remain "unreported" after 3 months of becoming due.

Whilst these measures may, in our view, have some impact on Phoenix activity, others may also recognise the changes as the Government acting aggressively to stem the level of debt outstanding to it with respect to taxation arrears. Taxation debt ballooned during the GFC with the ATO struggling to reign in that debt, particularly from the SME sector. We see the measures as having greater impact in the general collection arena, not solely from the minority of taxpayers who may engage in Phoenix style activity. The Government estimates that the measures will collect a further \$260 million over the next 4 years.

We await with interest the precise wording of the amendments set out in point 4 above, as these measures are likely to have broad ramifications for a number of companies.

Enhanced refund fraud detection and management

The Government has announced that \$56.4 million will be provided over four years to the ATO to address a substantial increase in fraudulent tax refund claims.

This will allow the ATO to develop further intelligence and analytic detection models to prevent instances of over claiming before refunds are issued.

Reporting taxable payments

From 1 July 2012, the Government will require reporting on an annual basis of payments made to contractors in the building and construction industry.

Additional funding will allow the ATO to undertake data matching, review contractors' tax liabilities, perform targeted audits and assist with educating the building and construction industry about the new regime and their tax obligations.

Reporting Government grants and payments

The Government will provide \$43.3 million over four years to the ATO to enable it to monitor the accurate accounting and taxation of Government grants and payments.

This will allow the ATO to collect payment information from Government agencies and provide for sophisticated data matching techniques.

International Compliance

On an international compliance front there are two noteworthy cost savings:

- \$2.5m has been cut from the Australian Crime Commission's Project Wickenby budget.
- \$12.1m over four years has been cut from the AUSTRAC budget – AUSTRAC is the agency that monitors cross border financial transactions and reports to agencies such as the ATO.

14 OTHER AMENDMENTS

Water reform relief

State and Territory reforms to streamline governance arrangements applying to private water supply and drainage systems will receive income tax relief from proposed amendments including CGT and capital

allowance roll-over relief. These changes will ensure that income tax is not an impediment to the reforms and will provide greater certainty to taxpayers about the application of the federal Water Market Rules 2009, remove unnecessary regulation and give water users flexibility to reconfigure their water delivery systems.

Luxury car tax

Consistent with the GST-free and Customs duty free treatment of imported art work or collectors' pieces, eligible entities (such as endorsed public museums and art galleries) will be able to import cars free of the luxury car tax. The implementation of this measure will be from the date of assent to the amending legislation.

Mineral Resource Rent Tax

The Government will adopt the recommendations of the Policy Transition Group (PTG) as the basis of the detailed framework for Australia's new resource tax arrangement. The key PTG recommendations cover issues regarding taxing point, starting base losses, deductions and tests for deductibility, a phased extension of the \$50 million threshold and transferability of expenditure and project losses.

Special Disability Trusts

Since 1 July 2006, families have been able to establish a Special Disability Trust (SDT) to provide for the needs of a family member with a severe disability. SDTs are eligible for social security means tested concessions. A range of capital gains tax concessions are to be introduced which relate to the transfer of a main residence to a SDT or the subsequent disposal of that residence by the SDT. These rules will apply to July 2006, being the earliest time a SDT was able to be established.

Farm Management Deposits

Primary producers affected by natural disasters will be able to access their Farm Management Deposits within 12 months of making a deposit and retain the concessional tax treatment available under the scheme. A number of minor administration changes will also be made to the scheme.

Further Information

Please ask your regular Johnston Rorke tax contact for further details on the issues raised in this Tax Bulletin.

JR Acknowledges the assistance of our national affiliates, Pitcher Partners, with the production of this Tax Bulletin.

DISCLAIMER: This bulletin is intended to provide a general summary only and should not be relied on as a substitute for professional advice.

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