

BUDGET UPDATE

COMMENTARY

The Treasurer handed down his second budget, sub-titled "Nation Building for the Recovery", announcing a \$57.6 billion deficit, falling GDP of 0.5% over the next 12 months and unemployment at 8.5% by June 2011.

There is no question that times are indeed hard.

The good news on the tax front is that most of the bad tax news had largely been foreshadowed in the press of recent weeks.

We now know that the personal tax rates have remained unchanged and we now know that the deductible superannuation contribution limits have been halved to \$25,000 for those aged less than 50 and to \$50,000 for those aged 50 and over. The changes will apply from 1 July 2009.

Some good news is that the small business tax break has been extended. It has been increased to 50% and the deadline for asset acquisition has been extended by 6 months to 31st December 2009, rather than 30th June 2009. The bad news is that the increased deduction and extended date only apply to those businesses with less than \$2m turnover.

Many will welcome the replacement of the existing research and development tax deduction with a research and development tax credit system, although we will need to wait and see how the definition of R&D will be tightened.

There are other significant changes to the tax system such as the abolition of the foreign investment fund provisions and the introduction of an elective capital gains tax regime for managed investment trusts. In addition, there are significant changes proposed in relation to off-market share buy-backs and employee share plan provisions. There are other integrity measures applying largely to wealthy Australians and buried in the Budget papers is the announcement of more than \$500m of additional funding for the ATO in order

to expand its compliance programs.

On the expenditure front, the centrepiece of the Budget is the \$22 billion investment in infrastructure including transport, education, clean energy and the National Broadband Network initiative, so hopefully many businesses can benefit from these expenditure programs.

PERSONAL TAXATION

For the income year commencing 1 July 2009 the resident personal tax rates (excluding Medicare Levy) will be:

Current Taxable income \$	Rate (%)	From 1 July 2009 Taxable income \$	Rate (%)
0 - 6,000	0	0 - 6,000	0
6,001 - 34,000	15	6,001 - 35,000	15
34,001 - 80,000	30	35,001 - 80,000	30
80,001 - 180,000	40	80,001 - 180,000	38
180,001+	45	180,001+	45

Foreign Employment Income – Exemption Substantially Narrowed

Income earned by Australian residents working overseas for more than 90 days can be exempt from Australian income tax. From 1 July 2009 this general exemption will be removed for all but a very limited range of employees.

Some employees including charity, aid, defence and police personnel as well as employees working on an overseas project approved by the Minister for Trade as being in the national interest may continue to

enjoy an exemption.

Those who may be disadvantaged by this measure are Australian residents working in a country with lower personal tax rates than Australia.

Employee Shares and Rights

The changes announced in respect of shares and rights (e.g. options) acquired under an employee share scheme applies to employee shares and options acquired after 7.30 pm EST on 12 May 2009. The measures will not affect employee shares or options already held by employees.

Currently there is the ability to defer taxation in respect of a qualifying share or option to a time later than the year of acquisition. This can extend to the year in which disposal and/or forfeiture restrictions lift in the case of shares and typically the exercise date in respect of an option. This ability to defer taxation will be removed and now all shares and options acquired under an employee share scheme will be assessable on the attributed discount in the year of acquisition.

Currently where an individual is provided with qualifying employee shares or options pursuant to an employee share scheme, and an election is made to include the assessable discount in the year or grant, the first \$1,000 of the discount is not taxable. These rules will be tightened with only those employees with a taxable income of less than \$60,000 (after adjustment for fringe benefits, salary sacrifice and negative gearing losses) being able to access the \$1,000 concession.

Family Tax Benefit

- Higher income thresholds used for determining eligibility or access to certain family payments will remain fixed until July 2012. These thresholds would ordinarily be indexed in line with the Consumer Price Index (CPI). The payments affected are the Family Tax Benefit Part B, dependency tax

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offsets, the Baby Bonus and the Family Tax Benefit Part A.

- Payment rates for the Family Tax Benefit Part A will be indexed in line with the CPI rather than the current arrangements which index the payments by the higher of a proportion of the combined couple rate of pension payments or the CPI.

Increases in the Medicare Levy Threshold

From 1 July 2008, the Medicare levy low-income thresholds will increase from \$17,309 to \$17,794 for singles and from \$29,207 to \$30,025 for families. The additional threshold for each dependent child will increase from \$2,682 to \$2,757.

The threshold for Pensioners below Age Pension will also increase from \$22,922 to \$25,299.

BUSINESS TAXATION

Changes to the Small Business and General Business Tax Break (Investment Allowance)

The Government has announced changes to the previously announced Tax Break that is to provide an additional tax deduction of either 30% or 10% of the cost of eligible new depreciating assets or new expenditure on existing assets. This tax deduction is in addition to existing depreciation deductions.

The changes have expanded the Tax Break available for small businesses, i.e. those businesses that have a turnover (including associates) of less than \$2 million a year.

The bonus tax deduction for small businesses will be increased from 30% to 50% of the cost of eligible assets. The time period to which the maximum tax break applies has also been extended and now covers eligible assets ordered between 13 December 2008 and 31 December 2009 which are installed by 31 December 2010, rather than the previously announced 30% tax break for eligible assets ordered between 13 December 2008

and 30 June 2009 which are installed by 30 June 2010.

Larger businesses are still eligible for the previously announced Tax Break at the 30% rate for assets acquired before 30 June 2009 which are installed before 30 June 2010 and 10% for assets acquired between 1 July 2009 and 31 December 2009 and installed before 31 December 2010.

The tables below summarise the key dates relating to the different rates at which the Tax Break can be claimed for taxpayers with a 30 June year end:

Small Business

	New Investment after 12 Dec 2008 and before 31 Dec 2009	
Installed by:		
30 Jun 2009	50%	in 2008/09
30 Jun 2010	50%	in 2009/10
31 Dec 2010	50%	in 2010/11

Larger Businesses

	New Investment After 12 Dec 2008 and Before	
	30 Jun 2009	31 Dec 2009
Installed by:		
30 Jun 2009	30% in 2008/09	
30 Jun 2010	30% in 2009/10	10% in 2009/10
31 Dec 2010	10% in 2010/11	10% in 2010/11

Capital Gains Tax (CGT) Limited Roll-Over for Fixed Trusts

The Government will proceed with the abolition of the "trust cloning" or "mirror trusts" CGT exemption with effect from 1 November 2008.

However, the Government will introduce a limited CGT roll-over for assets transferred between fixed trusts (trusts that have the same beneficiaries with the same entitlements and no material discretionary elements).

The transfer of assets from one trust to another trust would generally constitute a CGT event. The proposed CGT roll-over will allow trustees of eligible trusts to defer the CGT consequences of the asset transfer until the receiving trust subsequently deals with the asset. This will allow eligible trusts to restructure without immediate CGT consequences. This measure will be accompanied by appropriate integrity rules and will also apply from 1 November 2008.

Replacement of the R&D Tax Concession

The Government has announced significant changes in the format of the tax concession for R&D. Whilst on the surface the changes are positive, the devil may be in the detail.

Effective from 1 July 2010 the current tax concession will be abolished and will be replaced by a Tax Credit Scheme. The Credit Scheme will involve a two tier credit system for companies undertaking eligible R&D:

- a 45% refundable credit for companies with turnover of no more than \$20m (equivalent to a tax concession of 150%), and
- a 40% non refundable credit for all other companies (equivalent to a tax concession of 133%).

Unlike the current tax offset available for small business, the new credit scheme will not have an expenditure cap.

This means that for a company with a turnover of no more than \$20m, it will now be eligible for a tax refund of up to \$45,000 for every \$100,000 of R&D expenditure. This effectively doubles the current value of the standard R&D 'concession'.

- The current 175% Premium Concession and the International Premium Concession will be abolished.
- Foreign owned companies that undertake R&D in Australia will be entitled to the 40% non refundable credit.

However, the definition of what constitutes eligible R&D will also be tightened. The Government has advised that it will issue a consultation paper on this matter in the near

future. The extent to which the definition is sought to be changed is the issue which will be of greatest concern for those involved in R&D.

As an interim measure, from 1 July 2009 until the new scheme takes effect, the expenditure cap which applies to the R&D Tax Offset for small businesses will be increased from \$1m to \$2m.

Deemed Dividends for Discounted use of Private Company Real Property and Chattels

A payment, loan or the forgiveness of a debt by a profitable private company to its shareholders (or their associates) may give rise to a deemed unfranked dividend in the shareholders' (or their associates') hands. These deemed dividend rules are commonly known as "Division 7A".

Currently, the concept of "payments" in relation to the deemed dividend rules for the use of property is limited to situations where the use of property involves a transfer of property (such as a right to use real property that is made by way of a lease). The Government has announced that, from 1 July 2009, the concept of a "payment" will be broadened to include a licence or right (whether formal or informal) to use real property or chattels (e.g. cars, boats, planes etc) by shareholders (or their associates) for less than market value. Any discount on the charge for the use of such property may result in a deemed unfranked dividend to the user.

This amendment will produce compliance difficulties in determining which shareholders or associates have used a private company's property and what market value rates should be charged.

The Government has also announced that it will enact technical amendments to strengthen the deemed dividend rules. The only such amendment announced is to ensure that the deemed dividend rules also apply to corporate limited partnerships, but it is unclear what the date of effect of such amendments will be.

Withholding from Distributions by Closely Held Trusts

Under the current PAYG withholding requirements, an investment body (such as a bank, unit trust or a public company) must withhold an amount known as "TFN withholding" at the top marginal rate (currently 46.5%) from the interest or dividends payable on an investment, unless the holder of the investment has:

- quoted its ABN or its TFN to the investment body, or
- claimed an exemption from quoting a TFN to the investment body.

From 1 July 2010, the TFN withholding arrangements will be extended to closely held trusts, including family trusts where taxpayers have not provided a TFN to the trustee. Closely held trusts are trusts that generally have fewer than 20 beneficiaries.

This measure is aimed at ensuring that taxable distributions to a beneficiary of a closely held trust are included in the beneficiary's tax return. Individuals who have tax withheld by trustees can claim a credit for that tax in their tax return. This measure will not apply to income upon which tax is directly payable by the trustee of the trust, such as income assessable to minors.

Non Commercial Loss Rules

High wealth individuals operating loss making businesses may be impacted under the Government's proposal to impose further restrictions on accessing those business losses.

The non commercial loss rules currently permit an individual to apply their business losses against their income from other sources provided they satisfy one of four commerciality tests in relation to the business. Under the proposed changes individuals with adjusted taxable income over \$250,000 would be unable to rely on the commerciality tests to apply those losses to other income. Individuals with adjusted taxable income of \$250,000 or less may still rely on the tests.

The Commissioner's discretion to provide relief from the rules will

continue to apply to all taxpayers notwithstanding their taxable income.

The Government has flagged these changes as an integrity measure aimed at closing what it believes is a loophole existing under the current rules and exploited by a small number of taxpayers. With the government's own admission that these individuals number no more than 11,000 the measure would appear to be an unfair targeting of high wealth individuals for the sake of political point scoring as opposed to a genuine integrity measure.

Managed Investment Trusts – Electing that CGT is the Primary Code for Taxing Disposals of Assets

From the 2008-09 income year, eligible Australian Managed Investment Trusts (MITs) will be able to make an irrevocable election to apply the capital gains tax regime as the primary code for taxing disposals of eligible assets such as shares in a company, units in a unit trust and real property. The election will apply to all disposals of eligible investments in the first income year starting on or after the 2008-09 income year.

Investors in a MIT that makes the irrevocable election will be entitled to the CGT discount on eligible capital gains distributed by the MIT. Non-resident investors will be exempt from Australian tax on distributions of gains from the disposal of MIT assets other than where the assets are taxable Australian property.

This measure will make the taxation treatment of disposals of assets by MITs more certain and consistent with the taxation treatment applied to complying superannuation funds' disposals of similar assets.

Trusts that are taxed like companies are excluded from this measure. There will be integrity rules that require eligible trusts to meet the investment business rules in Division 6C of the Income Tax Assessment Act 1936. A number of implementation details remain to be disclosed by Treasury.

Off Market Share Buybacks

Companies implement off-market share buy backs as an efficient mechanism to return excess capital to their shareholders. The income tax regime for off-market share buy backs broadly dissects the share buy back price between a capital component (represented by the amount of share capital debited) and a frankable dividend component for the balance of the buy back price.

The Government and the ATO have been concerned for some time about perceived tax leakage created by off-market share buy backs to the extent that shareholders have enjoyed either dividend franking credit benefits or capital loss benefits. The Government will implement all 6 recommendations of the Board of Taxation to improve the income tax regime for off-market share buy backs with effect from the date of Royal Assent of the amending legislation. The recommendations cover technical amendments including:

- the removal of an ATO administrative cap on the level of discount to the market value of listed company shares;
- the specific prevention of streaming of franking credits to resident shareholders away from non-resident shareholders;
- the denial of notional revenue or capital losses accruing to shareholders that participate in off-market share buy backs conducted by listed companies;
- more clarity on determining the capital / dividend split for off-market share buy backs conducted by listed companies; and
- the specific dividend and capital streaming integrity provisions to continue to apply to off-market share buy backs conducted by unlisted companies.

INTERNATIONAL TAX

Current tax law contains numerous rules aimed at preventing tax deferral via offshore companies and trusts. These complex rules include the Controlled Foreign Companies (CFC), Foreign Investment Fund (FIF),

transferor trust and deemed present entitlement rules.

The Government announced that there would be substantial changes to these rules, including:

- the complete redesign of the CFC provisions;
- the expansion of the CFC rules to closely held fixed foreign trusts;
- the repeal of the FIF rules;
- the repeal of the deemed present entitlement rules;
- amendments to the transferor trust rules to enhance effectiveness and improve integrity; and
- the introduction of a targeted anti-avoidance provision to apply to interests in offshore accumulation and roll-up funds.

The Government is yet to reveal details for these proposed changes beyond a further consultative paper regarding the proposed CFC amendments. In addition, no clear indications as to the timing of these changes have been provided at this stage.

These proposed changes are significant and taxpayers with foreign entities should keep a close eye on them as they develop.

SUPERANNUATION

Reducing Concessional Contribution Caps

Concessional contribution caps will be reduced as was widely reported before the Budget. The changes will apply from 1 July 2009.

The current \$100,000 transitional cap applying to those aged 50 or over will be reduced to \$50,000 and the standard cap which is currently \$50,000 will be reduced to \$25,000. The new transitional cap will apply until 30 June 2012.

It appears that the scheduled indexation of the standard cap from 1 July 2009 has been removed meaning that the true reduction in concessional caps is larger than the 50% claimed by Government.

Non-concessional contribution caps do not appear to have been changed other than the removal of scheduled indexation which was set to apply from 1 July 2009. The non-concessional contribution cap will remain at \$150,000 per annum from 1 July 2009 and in future years will be pegged at six times the standard concessional contribution cap.

Going forward these changes make it vital that you consider maximising your superannuation contributions every year. The days of topping up towards retirement have been severely limited.

Extension of Pension Drawdown Reduction

The Government announced an extension to the 50% reduction in the required minimum pension amount for the 2009/2010 financial year.

This will mean paying minimum pensions for the 2010 financial year will be easier as it will be less likely that you will be forced to sell assets. We believe it may also make it more attractive for some clients to consider accessing their superannuation earlier as a pension.

Payment of Small Accounts to Government

The Government also announced that they will collect into consolidated revenue small or lost superannuation accounts from around 1 July.

GST

Response to Board of Taxation's Review of GST Administration

The Government has agreed to implement most of the recommendations made by the Board of Taxation following its review of GST administration. Many of the Board of Taxation's recommendations are designed to reduce GST compliance costs. Some of the key changes that will be implemented with effect from 1 July 2010 are as follows:

- Introducing a simpler BAS method for reporting GST refund positions;
- Simplifying the adjustment rules, with higher thresholds and fewer adjustment periods;
- Allowing a credit to be claimed through the adjustment rules for certain acquisitions that are made prior to the date an entity becomes registered for GST purposes;
- Allowing GST registered entities to support their claim for an input tax credit with documents other than a tax invoice, in circumstances where the tax invoice they hold contains minor errors or where they have been unable to obtain a tax invoice from the supplier;
- Adopting the income tax ruling system for GST purposes, with appropriate modifications including an exception for oral rulings;
- Introducing an option to treat supplies between GST registered businesses as fully taxable if it is unclear when entering into a transaction the extent to which the supply is taxable;
- Allowing suppliers and recipients to rely on GST private rulings issued to each other in relation to the supplies made between them;
- Simplifying the financial acquisitions threshold by

reducing the frequency of testing to an annual basis.

One 'integrity measure' that is to be implemented with immediate effect is to prevent taxpayers from claiming input tax credits for acquisitions that were made more than 4 years prior to the date the input tax credits are claimed.

The Government has announced that more flexible GST grouping rules will be introduced and that the rules relating to the GST treatment of going concerns and farmland will be reformed. Treasury has released a separate discussion paper which discusses different proposals for the implementation of these changes, which will be subject to public consultation.

Treasury is also to undertake reviews of the margin scheme and financial supplies provisions in the GST legislation, and the Board of Taxation has been asked to undertake a separate review of the GST treatment of cross-border transactions.

One important compliance recommendation made by the Board of Taxation that has not been accepted by the Government concerns the correction of GST mistakes. The Board of Taxation recommended that taxpayers should be permitted to correct GST mistakes in a current Business Activity Statement as opposed to being required to amend previously lodged Business Activity Statements. The Government has decided not to implement this recommendation.

GST and Representatives of Incapacitated Entities

The Government will amend the GST law to clarify that representatives of incapacitated entities are liable for, or entitled to, the GST consequences that arise from the actions of the representative. This amendment is in response to the Federal Court's recent decision in *DCT v PM Developments Pty Ltd* [2008] FCA 1886. The amendments will apply retrospectively with effect from 1 July 2000.

The Government will also ensure that the activities of a

representative are treated as activities of the incapacitated entity for the purposes of determining the GST consequences of the representative.

These amendments are in line with the policy intent of the GST law and are generally consistent with existing practice.

GST and Cross Border Transport Supplies

The GST treatment of cross border transport supplies has a number of inconsistencies that have resulted in increased compliance and GST costs for industry participants.

The focus of the changes announced in the Budget will be on the domestic leg of international transport supplies in relation to both exports and imports.

The Government will amend the GST transport provisions to ensure greater consistency between similar transactions and to eliminate the GST cost where the cost of the transport is ultimately borne by an overseas entity.

These changes are due to commence from 1 July 2010 and will be subject to the unanimous agreement of the States and Territories.

Carbon Pollution Reduction Scheme ("CPRS") – GST Treatment of Units

The Government will amend the GST law to ensure consistency of treatment for all CPRS units by treating them as personal property rights. This measure has previously been announced.

PRIVATE HEALTH INSURANCE

Changes to the Private Health Insurance Rebate

From 1 July 2010, the government will introduce three new "Private Health Insurance Tiers" in respect of the Private Health Insurance Rebate.

	Current MLS Threshold	Tier 1	Tier 2	Tier 3
Single	> \$70,000	\$75,000 - \$90,000	\$90,001 - \$120,000	> \$120,001
Couples	>\$140,000	\$150,001 - \$180,000	\$180,001 - \$240,000	> \$240,001
Medicare Levy Surcharge	1%	1%	1.25%	1.50%
Private Health Insurance Rebate				
Up to 65 years	30%	20%	10%	Nil
65-69 years	35%	25%	15%	Nil
Over 70 years	40%	30%	20%	Nil

Increases in the Medicare Levy Threshold

The Medicare levy low-income thresholds will increase on 1 July 2008 from \$17,309 to \$17,794 for singles and from \$29,207 to \$30,025 for families. The additional threshold for each dependent child will increase from \$2,682 to \$2,757.

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