



## Federal Budget Bulletin

### Federal Budget 2008/2009

The first Wayne Swan Budget has provided a huge \$21.7 billion surplus. This Budget is a balancing act for the Government, trying to keep inflation at bay and also meet its election commitments for tax cuts. There are also conflicting international messages, with the possibility of recession coming from the USA and continued boom times in China and India.

There is no big tax news in this Budget. That will have to wait for the release of the review of Australia's Tax System at the end of 2009. There are many tax changes in this Budget but most of them are small changes designed to fix anomalies in the existing system, many of which have already been announced. The personal tax cuts will be welcomed by most taxpayers but there are also some nasties in this Budget, such as the increase in the luxury car tax and the restriction of the definition of "family member" for family trust elections.

### Review of Australia's Future Tax System

The Government has announced a comprehensive review of Australia's tax system. The review will cover all Australian Government and State Government taxes except the GST and tax free superannuation payments for people over 60.

The review will be chaired by Dr Ken Henry, the current Federal Treasury Secretary. An initial discussion paper will be released by the end of July 2008 with the final report by the end of 2009.

### Personal Tax Cuts

The Budget confirms the previously announced tax cuts taking effect from 1 July 2008. The Budget also confirms the rates to apply in 2009 and 2010 (as previously announced):

#### Residents

The proposed rates and tax payable from 1 July 2008 for resident taxpayers are as follows:

Residents: Proposed Rates and Tax Payable from 1 July 2008	
Taxable income (\$)	Tax payable (\$)
0 - 6,000	Nil
6,001 - 34,000	Nil + 15% of excess over 6,000
34,001 - 80,000	4,200 + 30% of excess over 34,000
80,001 - 180,000	18,000 + 40% of excess over 80,000
180,001+	58,000 + 45% of excess over 180,000

The current and proposed personal tax rates and thresholds for resident individuals (*excluding the 1.5% Medicare levy*) are:

Residents: Personal Tax Rates and Thresholds							
Current		From 1 July 2008		From 1 July 2009		From 1 July 2010	
Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)	Taxable income (\$)	Rate (%)
0 - 6,000	0	0 - 6,000	0	0 - 6,000	0	0 - 6,000	0
6,001 - 30,000	15	6,001 - 34,000	15	6,001 - 35,000	15	6,001 - 37,000	15
30,001 - 75,000	30	34,001 - 80,000	30	35,001 - 80,000	30	37,001 - 80,000	30
75,001 - 150,000	40	80,001 - 180,000	40	80,001 - 180,000	38	80,001 - 180,000	37
150,001+	45	180,001+	45	180,001+	45	180,001+	45
<i>Low income tax offset</i>							
750		1,200		1,350		1,500	

### Low Income Tax Offset

The changes also affect the Low Income Tax Offset (LITO).

From 1 July 2008:

- The LITO will increase from \$750 to \$1,200. Taxpayers eligible for the full LITO will not pay income tax until their annual income exceeds \$14,000, up from \$11,000.

From 1 July 2009:

- The LITO will increase from \$1,200 to \$1,350, meaning the effective tax free threshold will increase to \$15,000.

From 1 July 2010:

- The LITO will increase from \$1,350 to \$1,500, meaning the effective tax free threshold will increase to \$16,000.

### Senior Australians Tax Offset

As a consequence of the increases in the low income tax offset, the tax free income threshold for eligible senior Australians will also increase. This will mean that eligible senior Australians will have no tax liability until their incomes reach:

- \$28,867 for singles and \$24,680 for each member of a couple in the 2008-09 income year.
- \$29,867 for singles and \$25,680 for each member of a couple in the 2009-10 income year.
- \$30,685 for singles and \$26,680 for each member of a couple in the 2010-11 income year.

### Increasing the Medicare Levy Surcharge Thresholds

The Treasurer announced that the Government will increase the Medicare Levy Surcharge Thresholds for singles from \$50,000 to \$100,000 and for a family from \$100,000 to \$150,000.

This measure of the Budget was leaked last week and it has met with criticism from the private health insurance industry with concerns that younger Australians will now not take up private cover, or will let their coverage lapse.

### Means Testing of Government Support Programs

It was announced from 1 July 2009 that the definition of "income" for the purpose of determining eligibility for a range of government financial assistance programs will be expanded to include forms of non-wage remuneration and, where appropriate, losses from discretionary activities.

The changes will mean salary sacrifice contributions to superannuation will be assessed as income for all relevant tax and transfer programs. The programs include income support payments for taxpayers below Age Pension age, family assistance, child support, superannuation co-contributions, and financial and retirement savings assistance delivered through the tax system.

Reportable fringe benefits will also be assessed as income in those government support programs that do not include them, with effect from 1 July 2009. The measure will mean that reportable fringe benefits will be included in the definition of "income" for the purpose of assessing eligibility for the dependency tax offsets, senior Australian tax offset and pensioner tax offset.

Net financial investment losses will be added to income in all applicable tax and transfer programs. Affected programs are family assistance, the Higher Education Loan Program and particular tax offsets. Net rental property losses will also be added to income for those programs where they are not already included.

### Dependency Tax Offsets

The Government will apply an income threshold so that those earning more than \$150,000 will not be entitled to claim the Dependent Spouse, Housekeeper, Child-Housekeeper, Invalid Relative and Parent/Parent-in-law tax offsets. This change will take effect from 1 July 2008 and will be indexed.

From 1 July 2009, the Government will align the definition of income for these offsets with that applying to family assistance payments. The new definition of income will be used for the claimant and the dependant.

### Increase in Child Care Rebate

From 1 July 2008, the child care tax rebate for out-of-pocket child care expenses will increase from 30% to 50%. The maximum out-of-pocket expenses claimable will increase from \$4,354 to \$7,500 (indexed) per child per year.

From 1 July 2008, the child care tax rebate will be paid quarterly instead of annually, with families receiving the first quarterly payments from October 2008. This measure will relieve the cash flow burden on those liable to pay child care fees.

### Family Tax Benefit Part B

The Government will limit eligibility for Family Tax Benefit (FTB) Part B to families where the primary earner has an adjusted taxable income of \$150,000 a year or less. The income test will be indexed annually by the consumer price index. These changes will apply from 1 July 2008.

The FTB will only be delivered through Centrelink and Medicare, removing claims from the Tax Office. This leaves the payment choices of fortnightly instalment or annual lump sum through Centrelink and Medicare.

Changes will be made to the definitions of income for family assistance purposes to include net financial investment losses and certain salary sacrifice superannuation contributions. These changes will apply from 1 July 2009.

### First Home Saver Accounts

The Government has announced changes to its previously announced First Home Saver Accounts regime. This regime allows taxpayers to save to purchase a first home in a tax concessional way. The main attributes of this regime are:

- The Government will provide a contribution of 17% of the first \$5,000 contributed to the account each year.
- Taxpayers will be able to contribute to the account until the balance reaches \$75,000.
- Earnings made on the account will be taxed at 15%.
- Withdrawals from the account are tax free if used to purchase or build the taxpayer's first home.

The commencement of this regime has been delayed until 1 October 2008 to allow account providers to develop their products.

## Small Business

### Capital Gains Tax

Effective for the 2007-2008 income year, the small business CGT concessions will be extended for taxpayers owning a CGT asset used in a business by a related entity, and for partners that own a CGT asset used in the partnership business.

The threshold tests for the small business CGT concessions are either the passing of the \$6 million asset threshold test or the small business entity \$2 million turnover test. Where a taxpayer passes the \$6 million asset test they may be entitled to the small business CGT concessions where the asset is used in the business of certain related entities.

However, currently the small business entity \$2 million test requires that the relevant taxpayer carry on a business, and therefore does not apply to business structures where the CGT asset is owned by an entity but is used in a related entity which carries on the business.

This measure was announced by the previous Government shortly before the last Federal Election.

### Entrepreneur's Tax Offset

The Government has announced they will introduce an income means test to the entrepreneur's tax offset. Under the entrepreneur's tax offset, a 25% tax offset is available for small businesses which have limited annual turnover. At present, there is no restriction on the other income that the taxpayer derives.

The changes announced in the Budget will introduce an income means test to restrict the availability of the offset to taxpayers who are genuine small business owners for whom the business is a primary source of income. The income test is \$70,000 for singles and \$120,000 for families (adjusted taxable income).

## Employee Share Schemes

The Budget announced two changes to the taxation of employee share schemes, one of which was announced in the Budget leaks last week, the other a technical amendment.

The first amendment involves a tightening of the administration of the employee share scheme election which, according to the Federal Government, was subject to abuse.

Under the employee share scheme provisions, employees can elect to be taxed up front on the value of the discount received on their shares or options, or they can defer the taxing point until any restrictions over the shares lapse, or when the options are exercised (and any share restrictions lapse).

Under the present system, employees were not required to formally lodge an election notice with their income tax return in the year they received their share and option entitlements. This left the system open for abuse, as employees were simply indicating (in a later income year) that they had made the election in the year in which the election should have been made, irrespective of whether they had actually done so. This may happen subsequent movements in the value of their shares or options made it beneficial for them to have made the election previously.

The amendment will require the employee to indicate in their tax return for the year in which they receive their shares or options, that they have taken the election, and to include in their taxable income any discount received on the shares.

The second amendment relates to the potential for double taxation where employee shares are held in an employee share trust. Double taxation occurs where a trust holds shares which were acquired as a result of the exercise of options under an employee share scheme.

The employee will be taxed on the discount on the shares and/or the capital gains derived from the ownership of the shares. From the trust's perspective, there is no Capital Gains Tax (CGT) relief as the shares are not treated as being employee share scheme shares, which is a requirement for CGT relief. The trust is taxable on the capital gains made on the shares whilst they are held in the trust.

The amendments will provide CGT relief in these circumstances.

## Fringe Benefit Tax Concessions Abolished

The following four popular fringe benefits tax (FBT) concessions have been amended to reduce their benefit to employees. All these changes will apply from 7:30pm EST 13 May 2008.

### Exemption for Work Related Items

There is an exemption from FBT for certain work related items such as mobile phones, laptop computers, personal digital assistants (PDAs) and tools of trade. However, the exemption conditions are not the same for all of these items. Some items have to be used primarily for work and others do not. Also, for some of these items the FBT exemption is available for only one such item per year, while for other items the exemption is available on multiple items. The law will be changed to ensure all work related exempt items are used primarily for work and will restrict the exemption to one of each type of item per year.

This change will mainly affect laptop computers, which previously did not need to be primarily used for work, and mobile phones and PDAs, for which you could previously obtain the exemption on more than one per year.

### No Depreciation for FBT Exempt items

Under the current tax law where an employee receives a depreciable item as an exempt fringe benefit, such as a laptop computer, they could also claim depreciation deductions for income tax based on the item's market value, even though they did not pay for it (assuming they use it for income producing purposes). This rule will be changed so that the depreciation deductions will not be available for these FBT exempt items.

### Salary Sacrifice of Interest Payments on Jointly Held Assets

Under the current law where an employee holds an income producing investment jointly with their associate and salary sacrifices the interest payments on a loan to finance the investment, the employer is exempt from FBT on the whole of the benefit under the otherwise deductible rule. The law will be changed so that the otherwise deductible rule will only apply to the portion of the interest that relates to the employee's share of the investment.

Although this change will apply from 13 May 2008, there are transitional rules for employees that have already entered into such a salary sacrifice arrangement so that the new rules will only apply from 1 April 2009.

### Meal Cards

The current law has an FBT exemption for property consumed on the business premises on a working day. Some employees have been salary sacrificing the cost of meals delivered to the premises to obtain the benefit of this exemption. The Government will change the law so that the property benefit exemption will not apply to salary sacrificed benefits.

## Corporate Tax Issues

### Tax Consolidation

The Government has also listed numerous tax consolidation amendments that it has agreed to enact some of which are listed below:

- the tax cost allocated to an asset will be used to work out the amount that is assessable income or allowed as a deduction under other parts of the law;

- change the pre-CGT factor rules so that, subject to certain integrity rules, the proportion of pre-CGT membership interests in an entity that joins a consolidated group is preserved when the entity leaves the group;
- ensure that, if an entity joins a consolidated group with a nil available fraction and transfers losses to the group, the capital gain that arises under CGT event L5 when the entity leaves the group is reduced in certain circumstances;
- ensure that, subject to certain integrity rules, consolidated groups can convert to multiple entry consolidated groups (MEC groups), and vice versa, with minimal tax consequences - this change will apply to conversion events that happen on or after 27 October 2006;
- change the tax cost setting rules so that units held in a cash management trust that have a market value equal to their face value are retained cost base assets;
- for the period between 1 July 2002 and 8 May 2007, ensure CGT event L7 will not apply to amounts that are recognised under another provision of the income tax law and, with effect from 8 May 2007, repeal CGT event L7;
- allow the head company of a consolidated group to reduce a capital gain arising under CGT event L3 by the value of doubtful debts held by a joining entity at the joining time - this change will apply from 8 May 2007;
- extend the single entity rule to shareholders who dispose of shares in the head company of a consolidated group, for the purposes of the CGT discount rules and CGT event K6 - this change will apply from 8 May 2007.

### Modify the Scrip for Scrip Roll-Over Provisions for Corporate Structures

With effect for arrangements entered into after 7.30pm EST on 13 May 2008, the scrip for scrip CGT roll-over provisions will be modified to ensure that, for corporate restructures, an acquiring entity's CGT cost base of shares in a target entity reflects the tax cost of the target entity's net assets.

This cost base will also be used in order to establish the tax cost setting amounts of the target entity's assets if the target entity subsequently joins the acquiring entity's tax consolidated group.

Under the current regime, the acquiring entity obtains a market value cost base for the shares that it acquires in the target entity. The Government is concerned that this can result in significant unintended tax benefits arising if the target entity subsequently joins the acquiring entity's consolidated group.

### Depreciation of Computer Software

The statutory effective life of in-house computer software for tax depreciation purposes will be increased from 2.5 to 4.0 years for expenditure incurred on or after 7.30pm EST on 13 May 2008. This means that taxpayers will now be required to write off computer software for tax purposes at an effective rate of 25% on a straight line basis rather than the pre-Budget rate of 40%. A four year depreciation period for expenditure on in-house software is the same period as the Commissioner's safe harbour effective life for computer hardware.

In-house software is computer software, or the right to use computer software, that is acquired, developed or developed by someone else, and is mainly used by the taxpayer in performing the functions for which the software was developed i.e. used as a business tool rather than developed for sale.

### Cancellation of Interests in Widely Held Entities

With effect from the 2006-2007 income year, taxpayers will be permitted to calculate their capital gains or losses using the actual proceeds received when shares or units in widely held entities are cancelled or surrendered.

Under the current tax law, when shares or units in widely held entities are cancelled, surrendered or similarly brought to an end, a taxpayer is required to calculate any capital gains tax liability using the assets' market value rather than the proceeds they actually receive.

For example, if a taxpayer receives no consideration on cancellation of their shares, and those shares had substantial market value immediately before the cancellation, under the current law they would be taxed on the market value of the shares. Under the new rules they will pay no tax.

## Taxation of Financial Arrangements

The former Howard Government introduced legislation, in draft form, detailing the 3<sup>rd</sup> and 4<sup>th</sup> stages of the Taxation of Financial Arrangements (TOFA) amendments.

The 3<sup>rd</sup> and 4<sup>th</sup> stages of the TOFA amendments significantly change the way in which many financial arrangements will be taxed, including allowing taxpayers to apply the relevant accounting standards to measure gains and losses on a variety of securities.

The Government announced in the Budget an intention to introduce these TOFA amendments with effect from 1 July 2009, with an elective commencement date of 1 July 2008.

In addition, the Government announced a further review and consultation period on these amendments prior to the release of the final draft legislation.

The Government also announced some technical amendments to earlier TOFA legislation. The first amendment relates to the taxation treatment of certain securities issued by financial institutions to support their tier 2 capital. The amendments will clarify the treatment of these instruments and ensure returns paid on these instruments will be treated as interest under the debt/equity rules.

The second amendment relates to the taxation of foreign exchange. These amendments are essentially technical amendments which will extend the availability of compliance savings measures to amounts which do not currently attract relief.

## Managed Funds

### Distributions from Managed Funds

The Government announced changes to the withholding tax rates applicable to distributions from managed investment funds to non-residents.

The new system is divided between those residents in jurisdictions which have effective exchange of information arrangements with Australia on tax matters, and those countries which do not have such arrangements.

For residents of countries which have these arrangements, the withholding tax on distributions from managed funds will be as follows:

- Distributions of dividends, interest and royalties – subject to the prevailing withholding rates for those forms of distribution.
- Distributions of other forms of income in the first year of the scheme – 22.5% non-final withholding tax (with deductions available for expenses relating to fund payments).
- Distributions of other forms of income in the second year of the scheme – 15% final withholding tax.
- Distributions of other forms of income from the third year of the scheme – 7.5% final withholding tax.

For residents of countries that do not have these arrangements, withholding tax will be payable on those distributions at the rate of 30%.

### Eligible Investment Rules

The Government also announced an intention to clarify the rules which govern the types of investment that managed funds are entitled to make whilst maintaining their status as a trust for tax purposes.

Under the proposal, the Government intends to clarify what is meant by “investing in land for the purpose of deriving rental income”. The proposal will also allow funds to derive a certain amount of non-rental income from investments in land (25%), as well as allowing funds to invest in a wider variety of financial securities and instruments.

## GST

The Government has announced four proposed changes that will be made to either the GST legislation or previously announced changes. The announced changes are summarised below:

### Real Property

In 2005 the then Liberal Government proposed changes to the margin scheme that would have had the effect of pegging that proportion of the non-taxable value of real property under the margin scheme at year 2000 values where the land in question was acquired as part of the sale of a GST-free going concern or GST-free farm land.

This measure was deferred on the understanding that more industry consultation was necessary.

As part of the 2008-2009 Budget the Government has announced that the previous Government’s measure will be dropped but that the GST legislation will be amended to ensure that where the margin scheme is used after a GST-free or non-taxable supply, the value added by the registered entity which made that supply is included in determining the GST subsequently payable under the margin scheme.

It is not immediately clear what Treasury has in mind with this amendment, although one suspects, given the previous attempt to change the law, that the value on which tax will be payable will include the value of any property not previously taxed.

If this assumption is correct, the inevitable result will be double taxation as, over time, it will be impossible to track that part of the value of land that has previously been taxed.

This measure is estimated to collect an additional \$90 million in 2008-2009 and an additional \$620 million over the life of the budget estimates. The new law will be operative from the date of royal assent.

### Refunds of GST

The GST refund provisions will be amended to further restrict the conditions under which a vendor is entitled to claim a refund. This amendment is a reaction to the refunds payable as a result of the decision in KAP Motors that certain sales incentives payable to motor vehicle retailers were held not to be consideration for any supplies made by the retailers.

What the Government is aiming to do is to ensure that GST refunds are only payable in circumstances where the amount refunded is paid to, or received by, an end user.

The problem with the proposed amendment is that it is founded in an assumption that vendors can add GST to their selling prices. However, the legislation is quite clear that GST can **never** be added to the price for which goods and services are supplied. Rather, the GST payable by a vendor is always a proportion of the price for which the goods or services are supplied.

### GST Relief for Charities

The previously announced amendments relating to charities and not-for-profits will not be proceeded with. These provisions were aimed largely at reducing the compliance burden faced by these organisations.

### GST and International Telecommunications

In the 2007-2008 Budget the previous Government announced amendments to the GST Act aimed at ensuring that international mobile roaming services would be GST-free. While the amendments proposed by the previous

Government will be changed, the net effect of the new amendments will be that such services remain GST-free in line with current Australian Tax Office policy.

## Other Indirect Tax Measures

### Luxury Car Tax

The rate of luxury car tax will increase from 25% to 33% with effect from 1 July 2008. This measure is estimated to raise a further \$555 million over the life of the Budget estimates.

### Excise Applicable to RTD's

Much has been written in the popular press about "alcopops" or ready to drink spirits (RTDs) as they are known in the industry. Where RTDs have an alcohol per volume that exceeds 10% the rate of excise will be increased to equate with that payable on full strength spirits which are currently subject to excise at the rate of \$66.67 per litre of alcohol.

This move is interesting as it leaves full strength beer and wine subject to excise at a lower rate than RTDs.

## Political Donations

With effect from 1 July 2008 contributions and gifts to political parties, members and candidates will not be deductible.

## Demutualisation of Health Insurers

Capital Gains Tax (CGT) relief will be provided to policy holders of health insurers who receive shares as a consequence of their insurer demutualising. These measures will apply with effect from 1 July 2007.

This will ensure consistency in the CGT rules which currently provide CGT demutualisation relief to non-life and general insurers for members of the demutualising entity but not for policy holders.

Under these measures, pre-CGT policy holders will receive a market value cost base for their shares and post-CGT policy holders will receive a CGT cost base that is referable to their share of the insurer's net tangible assets.

## Previously Announced Tax Changes

The previous Government left almost 60 announced but unenacted tax changes. The current Government is working through these announcements to determine which ones it will agree to enact. The treasurer has issued a list of these measures, and for most of them it lists the Government's decision.

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