BUDGET *UPDATE*

May 2010

With most of the taxation measures already announced in the recent Henry Tax Review, this budget contains few surprises for the tax paying community. Many of the proposed measures are intended to come into effect after the next election and to a certain degree will depend on the successful enactment of the Resource Super Profits Tax for funding.

SUPERANNUATION

When the Government released its initial responses to the Henry Review on Sunday 2nd May it announced that it accepted the following proposals put forward:

- A superannuation contributions tax rebate of up to $500 annually for low income earners, with effect from the 2012-13 income year.
- From 1 July 2012, the Government will allow individuals aged 50 and over with total superannuation balances below $500,000 to make up to $50,000 in concessional superannuation contributions. This doubles the cap of $25,000 (indexed) which is scheduled to apply from 1 July 2012.
- An increase in the superannuation guarantee (SG) rate from 9 per cent to 12 per cent, with increments of 0.25 percentage points in the first two years, and 0.5 percentage points thereafter. The increase will be phased in from 1 July 2013 to 1 July 2019.
- Workers aged 70 to 74 will be eligible to have SG contributions made on their behalf for the first time.

Last night's budget speech reiterated the government's acceptance of these proposals and contained the following additional proposed changes in relation to superannuation savings.

Permanent Reduction to the superannuation co-contribution matching rate and maximum payable

The Government will permanently retain the matching rate for the superannuation co-contribution at 100% and the maximum co-contribution that is payable on an individual's eligible personal non-concessional superannuation contributions at $1,000. The rate was due to increase from 2012-13.

Superannuation co-contribution—pause to the indexation of the income threshold for two years

Under the superannuation co-contribution scheme, the Government provides a matching contribution for contributions made into superannuation out of after-tax income. The matching contribution is up to $1,000 for people with incomes of up to $31,920 in 2009-10 (with the amount available phasing down for incomes up to $61,920). This measure will freeze these thresholds at $31,920 and $61,920 for two years.

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INDIVIDUALS AND FAMILIES

Aside from the proposed changes to superannuation individuals and families were largely forgotten when the government released their response to the Henry Review, some of the key proposed changes announced in last night's budget attempt to ease the cost of living and make tax time simpler for individuals and families.

Resident Individual taxpayers rates for 2010-11

The Rudd Government's third round of tax cuts will take effect **from 1 July 2010**. The rates for resident individuals are as follows:

Taxable income	Marginal rate*	Tax on this income
$0 – $6,000	Nil	Nil
$6,001 – $37,000	15%	15c for each $1 over $6,000
$37,001 – $80,000	30%	$4,650 plus 30c for each $1 over $37,000
$80,001 – $180,000	37%	$17,550 plus 37c for each $1 over $80,000
$180,001 and over	45%	$54,550 plus 45c for each $1 over $180,000

*Does not include the Medicare levy of 1.5% of taxable income, subject to low income thresholds and phase-in limits (see below).

Increase in the Low Income Tax Offset

- From 1 July 2010 the Low Income Tax Offset (LITO) will increase from $1,350 to $1,500. The increase in LITO will allow Australians to earn up to $16,000 and not have to pay income tax.

Increasing in the Medicare levy and Medicare Levy Surcharge low-income thresholds

- The Medicare low-income thresholds will be increased to $18,488 for individuals and $31,196 for families, with effect from 1 July 2009.
- The additional amount of threshold for each dependent child or student will also increase to $2,865.
- The Medicare levy threshold for single pensioners below Age Pension age will increase to $27,697, with effect from 1 July 2009. This increase will ensure that pensioners below Age Pension age do not pay the Medicare levy when they do not have an income tax liability.

Increase in the net medical expenses tax offset claim threshold

The Government will increase the threshold above which a taxpayer may claim the net medical expenses tax offset (NMETO) from $1,500 to $2,000 and commence annually indexing the threshold to the Consumer Price Index, with effect from 1 July 2010. The first indexation adjustment to the threshold will take place on 1 July 2011.

The NMETO allows taxpayers to receive a tax offset equal to 20 per cent of net unreimbursed eligible medical expenses above the threshold.

Standard deduction for work-related expenses and the cost of managing tax affairs

The Government will provide individual taxpayers with a standard deduction of $500 for work-related expenses and the cost of managing tax affairs from 1 July 2012. From 1 July 2013 the Government will increase the standard deduction to $1,000.

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Those taxpayers with deductible expenses greater than the standard deduction amount will still be able to claim their higher expenses, in-lieu of claiming the standard deduction amount. This will enable taxpayers to spend less time and effort preparing their tax return.

The standard deduction will reduce individuals' and families' adjusted taxable income for the purpose of determining their eligibility for transfer payments and other concessions. This will make some individuals and families eligible for transfer payments or eligible for a larger transfer payment.

50 per cent discount for interest income

From 1 July 2011, the Government will provide individuals with a 50 per cent tax discount on up to $1,000 of interest earned by individuals, including interest earned on deposits held in authorised deposit taking institutions, bonds, debentures and annuity products. Importantly, the discount will be available for interest income earned directly as well as indirectly, such as via a trust or managed investment scheme.

Capital protected borrowings — change to benchmark interest rate

The Government will adjust the benchmark interest rate that applies to capital protected borrowings to the Reserve Bank of Australia (RBA) indicator rate for standard variable housing loans plus 100 basis points, instead of the RBA indicator rate for standard variable housing loans as announced in the 2008-09 Budget. The measure will apply to capital protected borrowings entered into from 7:30 pm (AEST) 13 May 2008. The Government will also extend the transitional arrangements for capital protected borrowings entered into at or before 7:30 pm (AEST) 13 May 2008 from the announced 13 May 2013 to 30 June 2013.
Lifting the benchmark interest rate by 100 basis points will allow borrowers to allocate a smaller proportion of the expenses on the borrowings to the cost of capital protection, which is not deductible if on capital account.

Extending the current treatment for capital protected borrowings entered into on or before 7:30 pm (AEST) 13 May 2008 from 13 May 2013 to 30 June 2013 will reduce compliance costs for affected taxpayers in the 2012-13 income year.

BUSINESS MEASURES

Again most of the Henry Review changes accepted by government that impact on Australian business have already been released to the public, including:

- The Government will reduce the company tax rate from 30 per cent to 28 per cent in two steps, from the 2013-14 income year. The company tax rate will be reduced to 29 per cent for the 2013-14 income year and to 28 per cent from the 2014-15 income year.
- Small business companies will be able to move straight to the new 28 per cent rate, with effect from the 2012-13 income year.
- The Government will introduce a resource super profits tax (RSPT) on 1 July 2012
- The Government will allow small businesses to immediately write off all assets costing less than $5,000 (currently $1,000) and will allow most other assets (not including buildings) to be depreciated in a single pool at a 30 per cent rate. This measure will take effect from the 2012-13 income year.

The budget did contain a number of additional measures that will impact on business. The announced measures largely confirm changes to be made to a number of the more technical areas of taxation law currently under review.

Phasing down interest withholding tax on financial institutions

One of the Henry Review recommendations the Government did confirm is the phase down of Interest Withholding Tax (IWT) incurred by local subsidiaries and branches when they pay interest on borrowings from their overseas parents.

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This reform also extends to Australian-owned financial institutions borrowing from related parties overseas, and any financial institution borrowing offshore which they on-lend in Australia.

For local subsidiaries of overseas parents, the IWT rate will be reduced on such borrowings from 10% to 7.5% in 2013-14 and to 5% in 2014-15. The Government is favourably disposed to reducing this rate to zero, subject to its medium-term fiscal objectives.

Additionally, the IWT rate applying to borrowings by any bank branch from its overseas head office will be reduced from 5% to 2.5% in 2013-14 to zero in 2014-15.

Tax Consolidation: Calculation and collection of income tax liabilities

The Government will improve the operation of the rules relating to the calculation and collection of income tax liabilities from consolidated groups and multiple entry consolidated groups (MEC groups).

Film tax offsets - change in eligibility

The government will provide $6.9 million over four years from 2010-11 for changes to the film tax offsets program, administered by the ATO.

This measure will reduce the minimum qualifying expenditure threshold for the post, digital and visual effects (PDV) offset from $5 million to $500,000; and remove the requirement for films with qualifying expenditure of

between $15 million and $50 million to have at least 70% of the film's total production expenditure as qualifying Australian expenditure in order to qualify for the location offset.

Changes to CGT to make it easier for businesses to restructure

The Government will introduce legislation to make amendments to the CGT provisions to improve the ability of businesses to restructure.

The Government will:

- extend the CGT rollover for the conversion of a body to an incorporated company;
- make the share sale facility exclusion more broadly available for CGT rollovers; and
- allow CGT demerger relief for certain demerger groups that currently cannot access the relief.

Look-through treatment for earnout arrangements

Earnout arrangements are used to structure the sale of a business (or business assets) to manage uncertainty about the value of the business. Under the earnout arrangement, an earnout right may entitle the buyer or seller to additional payments depending on the subsequent performance of the business.

Currently, an earnout right is treated as a separate CGT asset. This treatment can result in anomalous outcomes for taxpayers, such as by reducing access to the CGT small business concessions.

The Government has announced it will allow all payments under a qualifying earnout arrangement to be treated as relating to the underlying business asset. The measure will have effect from the date of Royal Assent of the enabling legislation, with transitional provisions available in certain cases from 17 October 2007.

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BUSINESS MEASURES continued...

Further reductions in GST compliance costs for business

The Government will reduce compliance costs for businesses through a package of GST reform measures to help business owners spend less time wading through red tape.

The key components of the plan are:

- restructuring the margin scheme provisions with effect from 1 July 2012. These are currently a way of working out the GST payable when property is sold as part of a business. This will clarify and simplify the rules and ensure greater certainty for taxpayers on issues surrounding the use of valuations;
- significantly increasing the threshold above which businesses need to interact with the financial supply provisions from $50,000 to $150,000 of input tax credits with effect from 1 July 2012;
- introducing measures to protect the GST base by reducing opportunities for businesses to inappropriately take advantage of the reduced input tax credit concessions by bundling services; and
- allowing small businesses accounting for GST on a cash basis to claim input tax credits upfront in relation to hire purchase arrangements. This change will significantly assist those businesses that have been forced into higher cost chattel mortgages following the introduction of the GST.

The reforms are the result of three reviews into specific aspects of the GST announced in the 2009-10 Budget following recommendations by the Board of Taxation's Review of the Legal Framework for the Administration of the GST.

GST and cross-border transactions

The Government has also announced that it will implement all the recommendations of the Board of Taxation from its review of the application of GST to cross-border transactions, with effect from 1 July 2012. The package will significantly reduce the number of non-residents who are unnecessarily drawn into Australia's GST system, through limiting the connected with Australia provisions; expanding the compulsory reverse charge provision; extending the GST-free rules for cross-border supplies; and removing the need for some non-residents to register.

GST and cross-border transport supplies

The Government will make a number of minor revisions to its 2009-10 Budget measure that reduces GST compliance costs for businesses involved in the domestic transport of exported and imported goods, to ensure that the place of consignment will always be determined by the place of delivery under the principal contract.