

battalion legal

keepin' it simple

Federal Budget 2008/09

By Luis Batalha, principal and Jonathan Lim, consultant

May 2008

The release of the Rudd Government's Federal Budget for 2008/09 has caused some debate. There are a few surprises and some insight into the tax policy of the Government over the next few years. For the most part, however, the Government has stuck to its election promises.

This article concentrates on those amendments to taxation that will have a significant impact on tax professionals advising in the commercial sphere. The major relevant amendments are tabulated below with commentary. It will be seen that, in many respects, the Federal Budget will slightly dampen commerce and investment, mostly in the name of fairness. In other respects, as with the TOFA amendments, the changes will be welcomed by the world of commerce.

Personal income tax cuts

Measures	Current	Proposed	Start date
30% threshold	\$30,001 - \$75,000	\$34,001 - \$80,000	1 July 2008
40% threshold	\$75,001 - \$150,000	\$80,001 - \$180,000	1 July 2008
45% threshold	\$150,001 +	\$180,001 +	1 July 2008
Low income tax offset	\$750	\$1,200	1 July 2008

Commentary

The Rudd Government's planned personal income tax cuts, announced during the 2007 election campaign, are adopted in its first Budget without modification.

Further cuts in rates are planned into the following two income years. In

particular, where the Coalition planned to reduce the top marginal rate for the highest income earners, the Labor Government intends to delay this reduction until after 2010/11.

The Government claims that the tax cuts will encourage greater workforce participation.

Fringe benefits tax

Measures	Current	Proposed	Start date
Exemptions for work related items	Laptop computers, personal digital assistants and tools of trade were FBT exempt with only a limit of one of each type of item per FBT year, per employee. Private use of items was permitted without losing entitlement to exemption.	The new system will allow an exemption only where the item is used primarily for work purposes, and will limit the exemption to only one item, from the list of items, per employee, per FBT year. Also, all depreciation deductions in respect of FBT exempt items will be denied to employees.	13 May 2008
Jointly held assets - value of benefit	A benefit provided to an employee and an associate jointly did not have their full value taxed	Such jointly held assets will be taxed under FBT on their full value	13 May 2008
Meal cards	Meals consumed on an employer's business premises were exempt from FBT	Meals consumed on an employer's business premises under a salary sacrifice arrangement (including a meal card arrangement) are no longer FBT exempt	13 May 2008

Commentary

The exemptions from FBT in respect of both laptops and on-site meals have been significantly curtailed as a result of the changes effective from the time of the budget announcement. Both forms of benefit are popular with employers engaged in salary packaging. This change will therefore have an impact on how employees are remunerated by employers, reducing the options available for salary packaging.

However, in practice, it may prove difficult to prove that certain items are not being used for business purposes. If the Government is serious about reducing the use of the laptop exemption, it would have enacted more onerous substantiation provisions to ensure that the measures are properly complied with. Also, it is odd that the Government has chosen to attack a benefit that is widely relied upon by ordinary employees. By contrast, airport lounge memberships, for example, available to top executives, remain FBT exempt.

The Government claims that the new limit on the laptop exemption is simply designed to align the treatment of laptops with mobile phones, software and protective clothing.

The denial of depreciation deductions for exempt benefits prevents planning opportunities that currently permit a double benefit by allowing depreciation even though the benefit was FBT free.

The elimination of the jointly held asset loophole likewise gets rid of arrangements that benefited from the fact that couples had different marginal tax rates.

Employee share schemes

Measures	Current	Proposed	Start date
Improvement of integrity of election requirements	Currently, employees who receive discounts on shares/rights under an ESS often do not adequately report an amount they elected to include in their assessable income upfront	The proposed change will help ensure that employees who make an ESS election do include the entire discount amount in their tax return in the income year of	1 July 2008

		acquisition of the shares/rights	
Removal of double taxation	Employee shares under an ESS that are held in an employee share trust before distribution are often taxed under CGT when they are transferred to the employee, even though they are also taxed under the ESS provisions	A change to the measures will provide CGT relief for such transfers	13 May 2008

Commentary

These changes will have a minimal impact, aside from preventing double taxation of ESS shares distributed via trusts. This will make the use of such trusts for ESS distributions slightly more appealing.

The election requirements are being included as some taxpayers were claiming to have “forgotten” to put the assessable discount in their tax return. However, it is unclear what the provisions will actually require when they are enacted.

Family trusts

Measures	Current	Proposed	Start date
Definition of “family”	The definition of “family” in the family trust election rules is broad under rules introduced in 2007, covering lineal descendants, but also grand nephews, grand nieces etc	The definition of “family” is to be narrowed to include only children or grandchildren of the test individual or their spouse in “lineal descendants”	1 July 2008
Variation to test individual	A once-off variation to the test individual is permitted	No more once-off variations are permitted except where a marriage breakdown occurs	1 July 2007

Commentary

The changes proposed to the family trust provisions have caused a degree of debate, as they will remove a concession introduced only last year.

The main reason for this changes would appear to be a misuse of family trusts by persons seeking to use trust losses. The new restrictions will have a major impact on anyone seeking to make a family trust election and will reduce the appeal of using a family trust as an investment structure. Note that ex-spouses will still apparently count as part of the "family", thus avoiding imposition of family distribution tax on distributions under a Family Court order after a divorce.

Small business

Measures	Current	Proposed	Start date
Entrepreneur's tax offset	Entrepreneur's tax offset provides a 25% tax offset for small businesses with an annual turnover of less than \$75,000, with a phasing out for turnover exceeding \$50,000	A new income test will restrict eligibility to the ETO for persons whose income (including from sources outside than the small business) exceeds \$75,000 pa. (\$120,000 for families)	1 July 2008

Commentary

According to the Rudd Government, the present system allows persons with income from sources other than the small business itself to claim the ETO. The change will affect those who have been claiming the ETO even though a large amount of their income comes from other sources.

Typical with Labor Governments, the measure has been introduced to deny the availability of a tax concession to those who are perceived to be deriving income from other sources, and thus not in need of obtaining the benefit of the ETO. However, the "income testing" of the ETO is contrary to the policy behind the introduction of the "entrepreneur's" tax offset which was designed to encourage small business endeavours in Australia. With this purpose in mind, it is difficult to

see why the ETO should only be available to certain entrepreneurs but not to others.

Withholding tax on managed investment trusts

Measures	Current	Proposed	Start date
Withholding tax on managed investment trusts	At present, a 30% non-final withholding applies to distributions of Australian-sourced income of Australian managed investment trusts to foreign residents	The non-final rate of withholding, for countries with which Australia has effective exchange of information arrangements, will decrease to 22.5%. This will ultimately decrease further to a 7.5% final withholding in succeeding income years.	1 July 2008

Commentary

The reduction in the rate of withholding over the next three income years is intended to further Australia's role as a financial services centre. The restriction of the lowered rate to information sharing foreign jurisdictions prevents abuse of the measure by those seeking to evade tax.

However, this announced reduction has surprised some commentators, as the final tax rate will be half what was anticipated. Also, disappointment has been expressed that the change will only affect Australian managed investment trusts distributing Australian sourced income, rather than income irrespective of its source.

"Effective exchange of information arrangements" will probably include countries with which Australia has a current DTA.

Managed investment trusts in Australia that make distributions of income (other than dividends, interest and royalties) to foreign residents will benefit greatly from this reduction. In effect, the impact will be most widely felt among property trusts that distribute rental income.

CGT

Measures	Current	Proposed	Start date
Cancellation or surrender of shares or units in widely held entities	Currently, capital gains for such events are calculated based on the market value of the asset	A change will mean that capital gains or losses will be based on the actual proceeds received	1 July 2006
Scrip for scrip rollover	Currently the acquiring entity gets a market value cost base for the shares acquired in the target entity	The change will ensure that the cost base of the shares will reflect the tax costs of the net assets of the target entity	13 May 2008
Small business concessions	The small business test does not provide a concession where a CGT asset is owned by a partner but is used in a business by a related partnership	The change will provide concessions where the taxpayer is a partner who owns a CGT asset that is used in the business of the partnership	1 July 2007
Demutualisation provisions	The current system allows CGT relief to members of a health insurer that demutualises	The change will extend this CGT relief to policy holders as well as members	1 July 2007

Commentary

The first change will have an impact where share or units are cancelled or surrendered for capital proceeds that are less than market value.

The second change, to the scrip for scrip rollover, will prevent tax benefits that currently arise where the target entity subsequently joins a consolidated group of the acquiring entity.

The third change allows greater flexibility in structuring small businesses, particularly in the context of partnership arrangements.

The demutualisation reform will ensure that the CGT rules are aligned with the requirements of private health insurance legislation. It should be noted also that

pre-CGT policy holders will receive a market value based cost base for their shares.

GST

Measures	Current	Proposed	Start date
GST and real property	At the moment, when value is added to a property, this extra value is not included in the calculation of GST after the property has been acquired by the supplier under a GST free or non-taxable supply	Where the margin scheme is used after a GST free or non-taxable supply, it will become possible to include the value added by the supplier in calculating the GST subsequently payable under the margin scheme	Date of Royal Assent

Commentary

The Government alleges that over \$620 million in revenue will be raised by this one measure alone, which is intended to ensure that adding value to land means paying more GST when the land enters the GST system.

The measure is therefore likely to have a significantly detrimental impact upon the property development industry.

TOFA reforms

Measures	Current	Proposed	Start date
TOFA reforms	The Taxation of Financial Arrangements reforms, which have been debated for some 17 years, have not been fully introduced.	Stages 3 and 4 of the TOFA reforms will finally go through after the relevant Bill was prorogued last year, as a result of the announcement of the Federal election.	1 July 2009

Commentary

This long discussed reform to Australian tax law will finally proceed. However,

the start date will be 1 July 2009, not 2008 as contained in the 2007 TOFA Bill.

The TOFA reforms, stages 3 and 4, will tax certain financial arrangements so that all gains and losses related to them will be on revenue account. This reform will be welcomed by the financial sector, who have been pushing for the reforms for many years.

Depreciation

Measures	Current	Proposed	Start date
In-house computer software	In-house computer software is depreciated over 2.5 years	The depreciation period has now been increased to 4 years	13 May 2008

Commentary

In-house software only includes computer software, or the right to use computer software, developed by someone else and used by the taxpayer specifically for the function for which the software was developed. It cannot include software for resale.

This amendment will be disadvantageous to all taxpayers using in-house software, impacting in particular the IT industry.

Private rulings

Measures	Current	Proposed	Start date
Valuations as part of an ATO private ruling	The ATO does not charge applicants for valuations made in the course of a private ruling. Valuations may be done by registered and accredited valuers	It is proposed that the ATO be permitted to charge applicants for such valuations.	Not yet revealed

Commentary

This change will affect taxpayers who seek a private ruling which involves some

sort of valuation and does not use a registered or accredited valuer. Given the lack of announced start date, it may be preferable to bring forward any private ruling applications, if they involve the necessity for a valuation by the ATO, before the ATO commences charging for such applications.

It is difficult to reconcile this measure with all of the other measures announced by the Rudd Government. Charging for valuations in the context of private ruling applications is likely to place such applications beyond the means of certain individuals, discouraging them from obtaining private rulings. The private ruling process should be available to all, at no cost.

“The future of tax”

Simultaneously with the announcement of the Budget, the Federal Government also indicated its commitment to undertaking a comprehensive review of the Australian tax system (including state taxes but excluding the GST).

A final report will be due in 2009, with \$10 million being allocated to the review.

The proposed topics for review include:

- rebalancing the balance of taxes on work, investment and consumption;
- restructuring company taxation;
- review of state taxes on consumption and property; and
- simplifying the interaction between federal and state taxes.