



# Federal Budget Brief 2010–11



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# Unexpected gain not spending cut pain

## The Government is getting back to surplus faster than expected, not on the basis of spending cuts, but on unexpected revenue increases

The Treasurer has delivered a Budget that contains neither pre-election spending splurges nor hard decisions about spending cuts.

In framing the 2010-11 Budget, the Government faced a number of macroeconomic challenges and thorny policy issues.

Some of the difficult policy issues were of the Government's own making: The Commonwealth's health takeover, ongoing stimulus commitments, the postponement of the carbon pollution reduction scheme, the lack of response to the Henry Review's recommendations on shaping the tax and transfer payment system and the proposed resource super profits tax.

Some of the macroeconomic challenges come from the international sector. The fallout from the global financial crisis has meant growth globally remains sluggish, international financial markets remain volatile, and sovereign risk has been rising substantially, particularly in Europe.

That said, the international environment has also provided significant impetus to our economy, notably through the strong growth of China, India and other emerging economies. As a result of that growth and the Government's stimulus measures, the Australian economy has weathered the worst of the global financial crisis and in fact grew 1.4% in 2009-10. We are now well positioned with forecast GDP growth of 3.25% in 2010-11 and 4% in 2011-12. This is expected to return the Budget to surplus in 2012-13, three years earlier than previously forecast. Despite the improvement in the Budget bottom line, it is important that the Government shows a real commitment to spending discipline in the years ahead.

### The numbers at a glance:

- Inflation still within the RBA's target band
- Unemployment currently at 5.3% and expected to keep falling to 5% in late 2010-11, and 4.75% in late 2011-12
- Revenue from individual income tax expected to grow by 11% in 2010-11 and 2011-12
- Company tax revenues are expected to grow by 24% in 2010-11 and 17% in 2011-12
- Both sources of revenue are expected to outpace nominal GDP growth, which the government says will be 2.75% and 8.5% in the next two years
- Despite pre-Budget talk of spending cuts, the Government will spend \$9.5 billion more in 2010-11 than it expected to just six months ago
- Government spending will increase 0.9% in 2010-11
- The unexpected increase in revenue amounts to \$16.2 billion in 2010-11 alone, mostly from higher than expected company and individual tax revenues
- The Government's pre-election spending decisions are lower than in recent election year budgets.

# The Henry Review at a glance

On 2 May 2010, the Government released the first phase of its tax plan to build a stronger economy, and a fairer, simpler tax system. The plan is in response to the Henry Review's Report on Australia's Future Tax System, released the same day. The report contained 138 recommendations. A summary of the Government responses is set out below.

## Government response at a glance

### Company tax rate

The company tax rate will decrease from 30% to 29% in 2013-14, and to 28% in 2014-15. Small businesses are eligible for 28% from the 2012-13 income year. This should enhance the attractiveness of Australia as an investment location.

### Small businesses

From 1 July 2012, small businesses will be able to write off depreciating assets that are under \$5,000 in value. All other depreciating assets used by small businesses will be depreciated in a single pool at the rate of 30%.

### Resources

The Government has announced the resource super profits tax, (RSPT) a 40% resource rent tax which will apply to all mining and petroleum projects. This will commence from 1 July 2012. RSPT payments will be deductible for income tax purposes. Projects that fall under the petroleum resource rent tax (PRRT) are not included in the RSPT but will be given the opportunity to opt in. Companies will still have to pay royalties and levies to the states, with the Commonwealth providing a refundable credit for some of these amounts paid.

The Government will also introduce a resource exploration rebate from 1 July 2011 to act as an incentive for exploration so that exploration expenditure carried out in Australia will qualify for a refundable tax offset.

### Infrastructure

In 2012-13, the Government will establish a new infrastructure fund for the states. This fund is to support state infrastructure projects, including infrastructure necessary to develop Australia's natural resource wealth. The initial start-up amount for this fund will be \$700 million.

### Superannuation

There are several changes to the current superannuation regime. The most significant change is that the superannuation guarantee will increase from the current 9% to 12%, with increments of 0.25% effective from the 2013-14 year, increasing to 0.5% thereafter and reaching 12% by 2019-20.

As of 1 July 2013, the super guarantee age limit will also be raised from the current 70 years of age to 75. Those earning less than \$37,000 per annum will be eligible to receive up to \$500 contribution from the Government.

There will also be a concessional contributions cap of \$50,000 from 1 July 2012 for those who are over the age of 50, and with total superannuation balances of less than \$500,000. This is intended to provide an opportunity for those individuals to 'catch up' on their superannuation contributions.

# Personal taxation

## Personal income tax cuts

The Government will deliver its third tranche of personal income tax cuts. From 1 July 2010, the 30% threshold will be increased by \$2,000 to \$37,001 and the 38% marginal tax rate will be reduced to 37%. The Government has left all other personal income tax rates unchanged from those previously announced in the 2009-10 Budget. The proposed rates and thresholds are outlined below:

Current tax thresholds 1 July 2009 Income range (\$)	Tax rate %	New thresholds from 1 July 2010 Income range (\$)	Tax rate %
0 – 6,000	0	0 – 6,000	0
6,001 – 35,000	15	6,001 – <b>37,000</b>	15
35,001 – 80,000	30	<b>37,001</b> – 80,000	30
80,001 – 180,000	38	80,001 – 180,000	<b>37</b>
180,001 +	45	180,001 +	45

## Medicare levy

From 1 July 2009, the Medicare levy low-income threshold will be increased to \$18,488 (currently \$17,794) for individuals and \$31,196 (currently \$30,025) for couples, with the additional amount of threshold for each dependent child or student increasing to \$2,865 (currently \$2,757). These changes reflect the movements in CPI for the year.

## Low-income tax offset

Confirming the Government's announcement in the previous Budget, from 1 July 2010, the low income tax offset will be increased to \$1,500 (currently \$1,350) for incomes up to \$67,500 (currently \$63,750) from 1 July 2010 and will begin to phase out from \$30,000. Taxpayers eligible for the full low income tax offset will not pay tax until their annual income is over \$16,000 (up from the current \$15,000).

## What do the changes mean for you?

This table shows examples of the tax savings on the current rates for the 2010-11 year:

Taxable income	Tax savings
\$30,000	\$150
\$60,000	\$450
\$120,000	\$700

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

From 1 July 2012 the Government will provide individual taxpayers with an optional standard deduction of \$500 for work-related expenses and the cost of managing their tax affairs. The amount will increase to \$1000 from 1 July 2013. Taxpayers with expenses above the standard deduction will be able to continue to claim those expenses when lodging their tax return.

The announced change was one of several recommendations made by the Henry Review on personal income tax, and is aimed at reducing the cost of compliance for most individual taxpayers. It is seen as the first major step towards the introduction of pre-filled tax returns as a default method of settling individual taxpayers' tax affairs.

## Increase in net medical expenses tax offset claim threshold

The Government has announced that from 1 July 2010 the net medical expenses tax offset threshold will be increased to \$2,000 (currently \$1,500), and indexed annually (from 1 July 2011) to reflect the movements in CPI in subsequent years. Taxpayers can only claim the 20% tax offset for net unreimbursed eligible medical expenses that exceed the threshold for the relevant year.



#### **Reduction in childcare rebate**

The Government has announced a reduction of the childcare rebate cap per child to \$7,500 (currently \$7,778), and the freezing of its indexation for four years from 1 July 2010.

#### **First home savers' account (FHSA) scheme**

The Government proposes to make the FHSA scheme more flexible by allowing savings in a FHSA to be paid into an approved mortgage at the end of a minimum qualifying period. Currently, funds are required to be held for four years before they can be used to purchase a home, or if a home is purchased within the four-year limit, the balance in the FHSA was to be transferred to their superannuation. This proposal will help Australian first home buyers by allowing the funds to be withdrawn for the purchase of a home before the four-year holding requirement is reached.

#### **Changes to family tax benefit – part A**

The Government has proposed stricter requirements for families to be eligible for family tax benefit – part A (FTB-A) where they have children aged 16 to 20 who have not completed year 12 or an equivalent qualification. To remain eligible for FTB-A, it is now proposed that the children in these cases must participate in full-time education or training.

This proposal removes the option of allowing the children to participate in part-time education or training in combination with other approved activities, leading to year 12 or an equivalent qualification.

# Business

# Capital gains tax (CGT)

## Certainty for tax treatment of earnout arrangements

Earnout arrangements are entered into by the seller and buyer of a business or business assets to overcome uncertainty about the value of the business or those assets. A standard earnout arrangement gives the seller a right to additional post-sale payments if the business meets agreed performance thresholds. So-called 'reverse earnout arrangements' can also be entered into, under which the buyer has a right to receive post-sale payments in certain circumstances.

The release by the ATO of the draft Taxation Ruling TR 2007/D10 on 17 October 2007 made the tax treatment of earnout arrangements uncertain, particularly for the buyer of a business or business assets. An important issue arising from the ATO's draft ruling was the inability of the buyer to obtain cost base for payments made in discharge of its obligations under an earnout arrangement. For example, the market value of a right under an earnout arrangement granted by the buyer to the seller of a company might be \$100,000 at the time of the sale of the company. This amount would be included in the cost base of the shares acquired by the buyer. If the buyer later paid \$120,000 to discharge their obligations under the earnout arrangement, the additional amount of \$20,000 could not be included in the cost base of the shares. While clarification was sought from the ATO about whether the \$20,000 could be deducted by the buyer under the 'blackhole' rules, the ruling was not finalised and no guidance was provided on this issue.

The buyer's inability to include earnout payments in the cost base of shares acquired by the buyer also had broader ramifications for buyers that were members of, or that subsequently formed, consolidated groups. In the example above, the ATO's views in TR 2007/D10 meant that the buyer could not include the additional amount of \$20,000 in the allocable cost amount for the joining entity. This is despite the fact that there is a specific provision in the consolidation rules that is designed to achieve this outcome.

There are also a number of issues for the seller of a business or business assets that is granted rights under an earnout arrangement. Continuing with the example above, a seller would include the market value of the earnout right of \$100,000 in its capital proceeds, which would be used in working out its capital gain or loss on the sale of the company. If the seller received \$120,000 in discharge of its right, it cannot currently access the small business CGT concessions to reduce its capital gain of \$20,000. Furthermore, since the earnout right is taken to be acquired when it is issued, the 50% CGT discount is only available if the earnout right is held for at least 12 months. This is even though the shares in the company may have already been held for over 12 months.

The Government has announced that 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, which is when TR 2007/D10 was issued.

There is no detail about what will constitute a 'qualifying' earnout arrangement. For such arrangements, it appears that a 'look through' approach will be adopted, under which buyers and sellers will be able to ignore the earnout rights or obligations. There will need to be further consideration of how a look through approach would work in practice, for example one issue will be whether a seller can include an earnout payment in the income year in which they receive it or whether they must go back and amend their tax return for the income year in which the sale occurred. Although details of the proposed changes have not yet been released, it is hoped that they will overcome the issues highlighted above.

### CGT rollovers

The Government's 2010 Budget includes a range of amendments to the CGT rollover rules. There is one integrity measure and four specific changes, none of which are likely to have any significant impact on business activity.

#### Share sale facilities

Several CGT rollovers currently require that all interest holders exchange their interests in the original entity for interests in the new entity (for example, CGT rollover that deals with exchanging shares in one company for shares in another company).

Where non-resident shareholders are involved, however, it may be impractical or expensive for companies to comply with requirements in foreign jurisdictions.

In these circumstances, a share or interest sale facility may be used whereby the shares of non-resident shareholders are sold on their behalf and they receive cash instead. Accordingly, rollover relief may not be available, not just to those non-resident shareholders, but to all shareholders.

To alleviate this outcome, the proposed changes will provide that the use of such sale facilities will not prevent rollover being available. This is similar to the scrip-for-scrip rollover, which provides that capital proceeds received from sale facilities contemplated by the *Corporations Act 2001* do not prevent the offer being on substantially the same terms. Another example is the CGT rollover where stapled ownership interests are exchanged for ownership interests in a unit trust. There is a specific provision that allows foreign holders that utilise a share sale facility to be ignored when determining if the requirements for CGT rollover are met. This change will apply to CGT events happening after 11 May 2010.

Although this is likely to be the change that has the most far-reaching impact, the Budget papers note that this measure is expected to have negligible revenue impact.

A consultation paper has been released by Treasury with submissions due by 11 June 2010.

### Demerger groups

The demerger provisions will be amended to exclude corporations sole – companies that have no shareholders and, therefore, cannot satisfy the requirements for demerger rollover – and complying superannuation entities – who would breach regulatory provisions if they demerged interests in a demerger group – from being members of a demerger group. This will make it possible for such demerger groups to undertake a demerger.

For those groups affected, this will no doubt be a positive change.

This change will apply from 11 May 2010.

### Conversion of a body into an incorporated company

Rollover relief will be available for the conversion of certain Indigenous bodies into incorporated companies, including for any gains arising on the transfer of the assets to effect such conversion.

Relief will also be available to accommodate situations where a body is wound up and then reincorporated under a different corporations law.

This change will apply from 11 May 2010.

### Integrity measure

#### Rollover between fixed trusts

In the 2009 Budget, the Government announced that rollover would be available for transfers of assets between trusts that had no material discretionary elements (broadly, fixed trusts). The proposal is that this rollover will be limited as an integrity measure.

On 24 March 2010, this rollover was enacted and applies to CGT events on or after 1 November 2008. The Government has announced that it will refine this measure to ensure its integrity from that date. No details of the proposed change have yet been released.

### Previously announced changes

#### Aligning scrip-for-scrip rollover with the *Corporations Act*

On 6 January 2010, the Government announced changes to align the scrip-for-scrip rules more closely with the requirements of the *Corporations Act 2001* for certain takeovers and mergers. The 2010 Budget reiterates the Government's commitment to these changes, which are currently the subject of consultation.

This change will apply from 6 January 2010.

#### Water entitlements

On 2 December 2009, the Government announced that CGT rollover relief would be permitted for 'transformation arrangements', where an irrigator permanently changes (transforms) its right to water against an irrigation infrastructure operator into a statutory licence held by an entity other than that operator. The 2010 Budget reiterates the Government's commitment to these changes.

This change will apply from the 2005-06 income year. An exposure draft was released for consultation on 13 April 2010.



# Tax consolidation and liability for payment rules



A number of technical corrections to the operation of the consolidation provisions for both consolidated and MEC groups have been announced. The majority of these proposed amendments relate to the operation of the liability for payment rules for tax consolidated groups and MEC groups.

The liability for payment rules, contained within the tax consolidation provisions, specifically allow the ATO to collect and recover tax related liabilities from the head company and members of the tax consolidated group. The proposed amendments include clarifying that clear exit can be obtained for ROSA-related liabilities, changes to the liability for payment rules so that they operate appropriately for PAYG liabilities and so that the provisions also operate appropriately for MEC groups (especially where there is a change in a provisional head company).

While these amendments may be minor in form, they have implications for tax-sharing agreements of all tax consolidated groups and MEC groups. Once further details of these proposed amendments are released, it will be important for taxpayers to review their tax sharing agreements to ensure compliance with the proposed rules. This will be important both for measures with a retrospective application date, and those that are to apply from 11 May 2010.

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**It will be important for taxpayers to review their tax sharing agreements to ensure compliance with the proposed rules**

# Financial services reforms

The financial services sector should be generally satisfied with the Budget announcements. The Government has acted on a number of recommendations and generally supported, in principle, the majority of the recommendations in the Johnson Report, *Australia as a Financial Centre: Building on our strengths*.

## Phased reduction in interest withholding tax for financial institutions

The Government has announced a phased reduction in interest withholding tax for Australian and foreign financial institutions operating in Australia on funding from offshore markets.

The Government has committed to reducing interest withholding tax rates to 7.5% from 2013-14 and 5% from 2014-15. Significantly, the Government has indicated that it is favourably disposed to completely eliminating interest withholding tax for this proposal in the longer term.

The measure will apply to Australian banks that raise offshore deposit funds, including funds from their offshore subsidiaries. Funds raised from offshore retail deposits must be used, however, by the banks in their Australian business. This may introduce some compliance complexity, as banks will have to develop internal systems to trace the use of the funds in their Australian operations. The measure will not apply to non-resident retail deposits held in Australia.

The phased reductions in withholding tax will also apply to foreign banks operating in Australia. Currently, Australian subsidiaries and branches of foreign banks are subject to interest withholding tax on funds from their parent entities or head office.

This measure will be welcomed by the banking industry in Australia, which has lobbied extensively for the current interest withholding tax exemption to be broadened. This measure is consistent with the recommendations in the Henry and Johnson reports.

The phased reduction in withholding tax rates will not have any immediate material impact on the funding strategies of banks, but it will make some difference in the longer term. Australian-based banks will be able to supplement their offshore wholesale funding programs with potentially cheaper funding from offshore retail deposits. Reduced withholding tax rates should also increase the competitiveness of foreign banks operating in Australia, potentially creating flow-on benefits for Australian business borrowers.

As noted in the Henry Review, the effective withholding tax rate on offshore funding is quite low, at about 3.5%, given the existing wholesale funding withholding tax exemption and the relief available under some of Australia's double tax treaties. There are potentially some sources of offshore funding that banks in Australia are unable to attract because they would be subject to withholding tax and the banks would be expected to bear this cost, which makes this funding expensive. The cost to the Australian revenue of this measure will therefore be negligible, and has been estimated at about \$70 million from 2013-14.

### Investment manager regime (IMR)

The Government will begin consultation on an IMR to reform and expand Australia's managed funds industry by removing impediments to international investment. The objective is to improve the competitiveness of Australia's managed funds. The Johnson Report recommended that:

- An IMR of wide application be introduced, including retail and wholesale funds as well as other entities within the financial sector. The Government has announced that it will be important to the design of an IMR that non-residents investing in foreign assets will not face further Australian tax on their investments when using Australian fund managers (referred to as conduit relief). The Government also considers that an IMR should also provide that certain non-resident investments in Australian assets be treated as if the non-resident had invested directly, without the use of an Australian intermediary
- The Board of Taxation should review the scope for providing a broader range of tax flow-through collective investment vehicles.

Treasury and the Board of Taxation have released an IMR consultation paper, and submissions are due by 22 June 2010. The Government has indicated the terms of reference and dates for reporting of the review of collective investment vehicles will be released soon.

### Islamic finance products

The Government reiterated its support for a review of the law to ensure that Islamic finance products have parity of treatment with conventional products, having regard to their economic substance, as recommended by the Johnson Report. The Board of Taxation will undertake the review in accordance with a detailed terms of reference to be released soon.

### Other measures include:

- Establishment of a task force to continue work in this area
- Reduction in the withholding tax applied to a foreign bank branch on funding from its head office from 5% to 2.5% (2013-14) and to zero (2014-15)
- Agreeing to consultation on streamlining the offshore banking unit (OBU) application process, addressing the question of whether the OBU can choose what transactions to book, and updating the list of eligible activities
- In-principle support for the removal of state taxes and levies on the insurance sector, but left to the state governments to consider.

# Managed investment trusts (MITs) – Government response to the Board of Taxation’s review

The Budget reiterated several measures related to MITs that have previously been announced, including changes to the definition of an MIT for withholding tax purposes, clarifying the capital account treatment announced in the 2009-10 Budget and the Government response to the Board of Taxation’s review of MITs.

## **Definition of an MIT**

The definition of an MIT for withholding tax purposes is to be broadened to include certain wholesale managed investment schemes and certain widely-held pooled superannuation trusts. These changes will also more closely align those rules with, and have flow-on effects for, the MIT deemed capital account treatment measure. This measure is intended to apply from the first income year starting on or after the date of Royal Assent.

It is hoped that the amended definition will broaden the scope of the MIT withholding tax rules, which for income years commencing from 1 July 2010 provide for a 7.5% final withholding tax for distributions to qualifying foreign beneficiaries.

Importantly, the definition will also introduce tests to exclude trusts that are carrying on a trading business, are closely held, or are not managed in Australia. This may not be well received by overseas managers that are considering launching managed funds in Australia. The operation of the rules will be clarified to make it clear that they can apply in cases where the trust has only one member and that member is itself a specified widely-held entity. In particular, close consideration will need to be given to the meaning of “managed in Australia” in the amending legislation, and the extent to which it may limit MIT status.

## **Clarifying the capital account treatment**

As previously announced, the Government has indicated that it will refine certain aspects of the 2009-10 Budget measure that allows eligible Australian MITs to make an irrevocable election to apply the capital gains tax regime as the primary code of taxing certain disposals of eligible assets.

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## The definition of an MIT for withholding tax purposes to be broadened

### A new tax system for MITs

On 7 May 2010, the Government announced that it will put in place a new tax system for MITs, to commence on 1 July 2011.

The Government has initially accepted 38 of the Board of Taxation's 48 MIT recommendations. Features of the proposed new MIT tax system include:

- **New elective attribution model.** Replacement of the present entitlement system with an irrevocable election to apply the 'attribution' model for qualifying MITs to be known as 'regime MITs'. It is proposed that the new attribution system will provide that investors are only taxed on the taxable income that the trustee allocates to investors on a fair and reasonable basis, consistent with the investor's entitlements and rights under the trust's constituent documents. This is intended to address the current uncertainty for trusts reflected in the High Court decision in *Bamford*
- **Fixed trust treatment.** Qualifying MITs will be deemed to be fixed trusts for various tax law purposes. We note that the definition of an MIT is still subject to consultation
- **Unders and overs.** Establishing a formal carry-over facility into the next income year, to allow regime MITs to deal with 'over or under' distributions within a 5% cap of the net income of a regime MIT for a year, or a prescribed dollar value per unit (subject to further consultation). Although there are some elements of industry practice, there are some important distinctions:
  - Where an 'under' distribution exceeds the set *de minimis* (refer above), the trustee may reissue distribution statements to beneficiaries and undertake a revised attribution of taxable income. If the trustee does not reissue distribution statements or re-attribute within a certain timeframe, however, then the trustee will be assessed on the amount of tax shortfall at the top marginal tax rate
  - Where an 'over' distribution exceeds the set *de minimis*, a regime MIT trustee will have no choice but to reissue distribution and/or attribution statements to beneficiaries
- **A new approach to cost base adjustments.** Broadly, the cost base will be increased by the amount of taxable income attributed, and decreased by distributions received. This is different from the current treatment, which does not provide for a cost base uplift
- **Public trading trust rules.** Wholesale entities with more than 20% investment from complying superannuation funds and certain exempt entities will no longer automatically be considered 'public'. This means that some wholesale entities may no longer be subject to the public trading trust rules in Division 6C
- **New arm's length rule.** Abolishing Division 6B that relates to corporate unit trusts and replacing it with an arm's length rule that should apply to transactions between common interests or related interests of an MIT, including but not limited to subsidiaries and stapled entities. The arm's length rules will be particularly relevant for stapled structures
- **Product disclosure statement and other disclosure documents.** Regime MIT product disclosure statement or other disclosure documents will be required to identify the possibility for the taxable income attributed to beneficiaries to exceed the cash distribution, as well as specifically disclosing to beneficiaries the amount of their cost base adjustments annually. The Government will consult further on the appropriate extent of disclosure
- **Further consultation.** In-principle Government support for a number of other recommendations, on which the Government will consider and consult further with the managed funds industry, such as the rollover provision the Board of Taxation proposed if an amendment is made to an MIT's constituent documents so that no adverse tax consequences arise.

This is only an initial overview of the Government's proposed new tax system for MITs. There will be further sector and community consultation on the details and supporting legislation for the new MIT tax system in the coming months, which will need to be monitored.

# Superannuation and savings

## Savings discount

The Government has announced that from 1 July 2011, a tax discount equal to 50% on up to \$1,000 of interest earned on deposits held with any bank, building society or credit union, bonds, debentures or annuity products. For example, if a person invests \$16,500 in a bank deposit and it earns 6% pre-tax interest, that person would receive a savings rebate equal to 50% of \$990, i.e. \$495.

The Government has introduced the savings discount to reduce the discrepancy in tax treatment between interest and other non-interest bearing investments.

While the change will be welcome, it does not go as far as the Henry Review recommendation.

The Government has indicated that it will consult on the details of this announcement and will consider how the savings discount will apply to interest earned indirectly by individuals through trusts or managed investment schemes.

While this change will provide some incentive for people to save, it may affect decisions about investing into superannuation. Individuals will be comparing the savings discount with any relevant superannuation concessions, including whether their personal contributions could qualify for the government co-contributions.

## Permanent reduction in the government co-contribution

As indicated above, low and middle income earners may receive super co-contributions from the Government by making eligible personal superannuation contributions to their funds. In last year's 2009-10 Federal Budget, a temporary reduction in the co-contribution was announced:

Year ending	Government co-contribution rate	Maximum Government co-contribution
30 June 2009	150%	\$1,500
30 June 2010	100%	\$1,000
30 June 2011	100%	\$1,000
30 June 2012	100%	\$1,000
30 June 2013	125%	\$1,250
30 June 2014	125%	\$1,250
30 June 2015	150%	\$1,500

In this year's Budget, the Government has announced that this reduction will be permanent and the maximum government co-contribution rate will be 100%. The Government has also announced that the relevant

co-contribution income thresholds that determine whether an individual qualifies for the full, partial or no co-contribution will be frozen for two years. The lower income and higher income thresholds will be frozen at \$31,920 and \$61,920.

While this change will provide some savings for the Government, it will affect a person's superannuation where that individual was looking for the Government co-contribution to supplement their personal contributions.

## Terminal medical condition benefits

The Government will extend the range of benefits that are deductible by complying super funds to include terminal medical condition benefits.

This amendment will fix the inconsistency between the Superannuation Industry (Supervision) (SIS) legislation and the tax legislation, and will have effect from 16 February 2008 when the superannuation legislation was introduced.

Once the amendment is introduced, funds will need to consider whether they have any costs for terminal medical condition benefits that should be treated as tax deductible.

## Other announcements

The Government has also indicated that from the 2010-11 income year:

- Eligible contributions made to successor super funds will be permanently deductible
- The time limit for deductible employer contributions made for former employees will be extended
- The due date of the excess contributions tax shortfall interest charge will be clarified
- The ATO will be able to exercise its discretion under the excess contribution tax before an assessment is issued
- New arrangements will be introduced for public sector defined benefit schemes that fund benefits through 'last minute contributions'.

No further details have been provided about any of the above. Those affected will need to monitor developments of these announcements to determine the impact of the changes on their positions.

# Goods and services tax (GST)

The Government has announced a number of GST reforms. These mostly represent a response to the Board of Taxation's recommendations previously announced in December 2008. There are, however, a number of additional reforms.

## **Government response to Board of Taxation report: GST cross-border transactions**

The Government has announced that it will be implementing all of 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 cross-border reform package is intended to reduce significantly the number of non-residents who are unnecessarily drawn into Australia's GST system by:

- Limiting the 'connected with Australia' provisions
- Expanding the compulsory reverse charge provisions
- Extending the GST-free rules for cross-border supplies
- Removing the need for some non-residents to register.

These reforms aim to limit the jurisdictional reach of the Australian GST. The rules provide a more practical approach to the application of the GST to non-residents.

## **Government response to Board of Taxation report: Minor changes**

The Government has delayed certain measures from last year's Budget. These measures followed the Board of Taxation's review of the GST administration framework. The start date for these measures has been revised to 1 July 2011:

- Adopting the income tax self assessment regime for indirect taxes (R 21)
- Refreshing the period of review (R 19)
- Reforming the change of use adjustments (R 4)
- Allowing adjustments for pre-registration acquisitions (R 8)
- Clarifying the GST treatment of tax law partnerships (R 36)
- Simplifying the GST grouping membership interest rules and allowing grouping of non-operating holding companies (R 32(a))
- Introducing a reverse charge for supplies of going concerns and farmland (R 33).

In most cases, these recommendations were originally intended to apply from 1 July 2010.

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**The cross-border reform package is intended to reduce significantly the number of non-residents who are unnecessarily drawn into Australia's GST system**

### **Reforms to the arrangement for exempting taxes, fees and charges from GST**

The Government has announced it will amend the GST law to replace the current mechanism for exempting Australian taxes, fees and charges with a principles-based legislative exemption, with effect from 1 July 2011.

Currently, the GST law specifies that Australian taxes, fees and charges are exempt from GST if they are included in a lengthy determination made by the Treasurer. The Government considers that a principles-based legislative exemption will provide:

- Increased certainty for taxpayers and government agencies about the GST treatment of new taxes, fees and charges, because the GST treatment will no longer depend on the item being listed in the Treasurer's determination
- A more effective and transparent approach to exempting Australia taxes, fees and charges from the GST.

### **Reforms to the GST financial supply provisions**

The Government has announced that it will make various amendments to the GST financial supply provisions, with effect from 1 July 2012. The reforms include:

- Increasing the financial acquisitions threshold (FAT) from \$50,000 to \$150,000, which will enable small business and one-off financial supply providers to avoid restriction of GST recovery of associated costs
- Simplifying the GST treatment of hire purchase agreements
- Reducing opportunities for businesses to take advantage of the reduced input tax credit concessions inappropriately by 'bundling' services.

### **Reforms to the GST margin scheme**

The Government has announced that it will clarify and simplify the current GST margin scheme provisions, with effect from 1 July 2012. The Government has also stated that a minor technical amendment will be made to ensure that a valuation can be obtained for the purposes of using the margin scheme for subdivided land.

### **GST and cross-border transport supplies**

The Government has announced that it will make a number of minor revisions to its 2009-10 Budget measure that reduces the GST compliance costs for businesses involved in the domestic transport of exported and imported goods. These measures will ensure that:

- The place of consignment will always be determined by the place of delivery in the principal contract
- Ancillary services to the international transport of goods receive the same GST treatment as the transport supply that they facilitate.

This announcement follows Treasury's release of draft legislation and explanatory material on 26 February 2010. The exposure draft legislation includes amendments to streamline the application of GST to the domestic transport of imported and exported goods.

### **GST compliance program – working together to improve voluntary compliance**

The Government will provide \$337.5 million over four years, (i.e. 2010-11 to 2013-14 income years) to the ATO to fund additional activities that promote voluntary GST compliance.

# Fuel tax – amending the arrangements for fuel ethanol

The Government has announced that it will amend the 2004-05 Budget measure to introduce an energy content-based fuel excise system. The excise and excise-equivalent customs duty rate for ethanol will be set at 25 cents per litre, from 1 July 2011 phasing down to 12.5 cents per litre from 1 July 2015.

There will be an offsetting grant payment to domestic ethanol producers that will be progressively reduced from 22.5 cents per litre on 1 July 2011 to zero by 1 July 2015. There will be no offsetting grants for excise-equivalent customs duty.

# Research and development (R&D)

The Government has reaffirmed its commitment to introduce legislation shortly after the Budget to replace the current R&D tax concession with an R&D tax credit, to apply for income years starting on or after 1 July 2010. This legislation will be based on the second exposure draft issued on 31 March 2010 for public comment. The exposure draft still contained a number of issues of significant concern for stakeholders. It is not yet clear whether the concerns expressed are addressed in the final legislation.

The proposed lowering of the corporate tax rate to 29% in 2013-14 and 28% in 2014-15 will increase the net benefit of the R&D tax credit from 15% for small to medium-sized enterprises (those with a turnover of less than \$20 million a year) to 16% and then 17%. For corporates with turnover over \$20 million a year, the net benefit will increase to 11% and then 12%.

The Government's ambition is to increase the proportion of businesses engaged in innovation by 25% over the next decade. This objective is underpinned by the introduction of the new R&D tax credit, together with continued investment in corporative research centres and Commercialisation Australia. Other measures include a reduced commitment to the Green Car Innovation fund and venture capital programs. It remains to be seen if this mixed basket of measures will achieve this ambitious objective.



# Climate change – renewable energy

The Government has confirmed its commitment to an emissions reduction target of between 5% to 25% below 2000 emission levels by 2020. They also announced a \$652 million (over four years ending 2013-14) renewable energy future fund as part of an expanded \$5.1 billion clean energy initiative (building on the \$4.5 billion already announced in the 2009-10 Budget).

The Renewable Energy Future Fund will be used to support early stage investment renewable energy projects. The fund is also expected to support the development and commercialisation of low-emissions technologies.

It will also be used to enhance Australia's take-up of energy efficiency, including helping households and businesses reduce their energy consumption.

The Treasurer noted that this complements the renewable energy target scheme.

Once the details are announced, businesses will need to factor this into any renewable energy strategy and look at potential benefits from access to funding and intellectual property.

This announcement supports the Government's aims of developing a low-carbon economy and supporting the transition.

# ATO compliance program

The Government will provide an additional \$107.9 million over four years to the ATO to target tax avoidance by some small businesses who conduct some or all of their business in the cash economy.

The additional funding will be used to increase the visibility of the ATO in the small business community and to improve the level of tax compliance of those small businesses who deal in the cash economy. The additional funding provided is expected to result in an additional \$366.5 million in revenue over four years.

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[More ATO resources targeting cash economy](#)

# Minor announcements



## **Film tax offsets — change in eligibility**

From 1 July 2010, the Government will remove the current requirement for productions valued between \$15 million and \$50 million to spend a minimum of 70% of their production budgets in Australia. The post digital and visual effects production threshold will also be reduced from \$5 million to \$500,000. The proposed changes are designed to make Australia a more attractive destination for film making and to enable more businesses, particularly small businesses, to benefit from the film tax offsets.

## **Improvements to the tax running balance account provisions**

Interest will be paid to taxpayers if an overpayment arises because of an amended franking deficit tax assessment. The date of effect is yet to be announced.

## **Capital protected borrowings — change to benchmark interest rate**

The Government will adjust the benchmark interest on these borrowings from 11 May 2010. The new benchmark rate will be 1% above the old rate, which was based on the Reserve Bank indicator rate for standard variable housing loans. Essentially this will mean that a borrower will get a bigger deduction, because a smaller proportion of the cost of borrowing will be attributed to the capital protection element. Transitional arrangements have also been extended until 30 June 2013 for capital protected borrowings entered into on or before 13 May 2008. Treasury released exposure draft legislation on Budget night.

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Designed and produced by Aqua Media, AM\_Syd\_05/10\_041246

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