

## Reality hits Budget bottom-line (and high income earners)

What a difference a year makes.

Australia now faces a \$32.1 billion forecast deficit for 2008-09, compared to the \$19.7 billion surplus last year. Unemployment could reach highs of 8.5 per cent by 2010-11. Real GDP is not forecast to grow again until 2010-11. No one has any qualms about using the word “recession” now.

The adverse impact of the Global Financial Crisis on tax collections, and the cost of further economic stimulus measures on infrastructure, have left Treasurer Wayne Swan scrambling for cost savings and additional revenue.

Nonetheless, the Rudd Labor Government continues to deliver on key promises made to “working families” in the 2007 Federal Election. The political context of this Budget is now of growing interest. With Labor still ahead in the polls, the Senate will be mindful of triggers for an early election.

Behind the scenes, work continues on a major review of the tax system. Recommendations should be in the Government’s hands by the end of 2009. A globally competitive (lower) company tax rate is high on the agenda in submissions lodged by leading business groups.

It comes as little surprise that the Budget targets high income earners through the withdrawal of benefits and the targeting of tax planning strategies. Some will complain that Labor has used the economic crisis to engineer a tax redistribution with little economic benefit to show for it. Finally, the superannuation sector – which desperately wanted to be left alone – is again a casualty of policy change.



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## 2009 Federal Budget at a glance

- From surplus to deficit (and back again slowly)

The Treasurer forecasts that the Budget will not revert to surplus until 2015-16. Here is the medium term outlook:

Table 1: Cash surplus versus deficit

Year	Underlying cash surplus or deficit (\$ billion)	% of GDP
2007-08	19.7	1.7
2008-09 (estimate)	-32.1	-2.7
2009-10 (estimate)	-57.6	-4.9
2010-11 (estimate)	-57.1	-4.7
2011-12 (estimate)	-44.5	-3.4
2012-13 (estimate)	-28.2	-2.0

- Into recession (and out again quickly)

Much depends on the recovery of the global economy, but the Treasurer expects a positive GDP trend to emerge by 2010-11.

Table 2: Real GDP growth

Year	Real GDP growth %
2007-08	3.6
2008-09 (estimate)	0
2009-10 (estimate)	-0.5
2010-11 (estimate)	2.25
2011-12 (estimate)	4.5

- Inflation (Consumer Price Index) of 1.75 per cent forecast for 2009-10, the same as the estimate for 2008-09.
- Unemployment rate forecast at 8.25 per cent for 2009-10, compared with estimated 6 per cent for 2008-09.
- A current account deficit forecast for 2009-10, averaging 5.25 per cent of GDP. The deficit is forecast to widen as a result of falling commodity prices.
- Personal income tax cuts legislated to commence on 1 July 2009 will be delivered.
- New revenue raising initiatives include:
  - a 50 per cent reduction in the deductible contribution caps for superannuation (\$2.75 billion over four years)
  - lower private health insurance rebate entitlements for high income earners, with an increase in the Medicare surcharge for those without private hospital cover (\$1.9 billion over five years)



- a temporary reduction in the superannuation contribution co-contribution matching rate (\$1.4 billion over four years)
  - a pause in the indexation of upper income eligibility thresholds for Family Tax Benefit (A & B), the Baby Bonus and dependency tax offsets (\$1.4 billion over four years)
  - changes to employee share ownership tax timing rules (\$200 million over four years), and
  - tightening of the current rules for non-commercial business losses (\$700 million over three years).
- Other tax changes of interest to business include:
    - elective capital gains tax treatment for gains and losses made on the disposal of investment assets by managed investment trusts
    - a simplified research and development tax credit to replace the current Research and Development (R&D) concession
    - a re-write of the controlled foreign company rules
    - the repeal of the foreign investment fund rules in favour of a specific anti-avoidance provision to counter tax avoidance involving offshore entities
    - an increase in the investment allowance for small business to 50 per cent (compared to the previously announced 30 per cent or 10 per cent entitlements), provided various eligibility criteria are satisfied
  - Proposed tax changes impacting individuals will:
    - withhold tax on distributions from closely held trusts (including family trusts) where no tax file number is quoted, and
    - extend the deemed dividend rules to circumstances where shareholders and their associates have a licence or right to use real property and chattels held in a private company.
  - Spending initiatives include:
    - nation building infrastructure projects focusing on transport, energy, communications, education and health projects
    - an extension of the First Home Owners Grant for six months, with current entitlements retained until 30 September 2009, and reduced entitlements for the remaining three months
    - extra funding to “uncap” the number of public university places for eligible students, resulting in an additional 50,000 new students receiving places by 2013
    - a “Compact with Young Australians” which will guarantee training places for every person under 25 who wishes to undergo training
    - an increase in the age pension, but accompanied by a revised income test, faster benefit withdrawal where private income is derived, and a staged increase in age pension age from 65 (in most cases) to 67 years by 2023, which will impact those entering the pension system from 1 July 2017, and
    - paid parental leave from 2011.

# Economic outlook

## Overview

Almost before the ink was dry on Treasurer Wayne Swan's 2008 Budget forecast of a mild and painless slowdown in growth, and with a near audible "thud", Australia's economy has hit the wall.

The world has witnessed the most severe, synchronised downturn in economic growth since the Great Depression. Australia could not hope to find itself immune to such pressures.

Crafting a Budget in such difficult economic times is hardly an enviable task. Though Australia's recession is expected to be milder and shorter than in virtually every other developed country, the near term economic outlook is bleak. Unemployment is expected to top 8 per cent in the coming year, a result of the economy contracting by 0.5 per cent in 2009-10, and a six-year run of Budget surpluses has ended.



Table 3: Key 2009 Federal Budget outcomes

	2008-09	2009-10
Budget surplus or deficit‡ (\$bn)	32.1	57.6
Percentage of GDP	2.7%	4.9%
GDP growth or decline (real)	0%	-0.5%
Employment growth	-0.25%	-1.5%
Wages growth	4.25%	3.25%
Consumer Price Index	1.75%	1.75%
Unemployment	6.0%	8.25%

‡ Underlying cash balance

## Deficit exit strategy

It seems every Budget coins a new phrase. Last year, Treasurer Swan introduced us to his "working families" – mentioned no less than 13 times in the Budget speech – and the Budget was centred on a \$55 billion "Working Families Support Package".

Now, Australians are coming to terms with the notion of a "deficit exit strategy": a two-pronged strategy of Commonwealth spending restraint and an anticipated medium-term rebound in economic growth. Treasury believes this will pull Australia's Budget out of the red by 2015-16.

It is a mammoth task. The forecast 2009-10 Budget deficit is \$57.6 billion, or nearly 5 per cent of Australia's Gross Domestic Product (GDP). In the space of just 12 months we have seen the Budget's underlying cash balance deteriorate by more than \$77 billion – the difference between last years' forecast surplus for 2009-10 and the now-anticipated deficit.

Just less than two thirds of this variance is attributable to “parameter and other variations” – Treasury speak for getting the underlying economic forecasts wrong. The balance is a result of “policy decisions”, covering a host of spending and financial transfer initiatives implemented in the last year.

Importantly, Treasury forecasts show that these policy decisions have had a significant and positive impact in moderating the effects of the global recession on Australia’s economic performance. While unemployment has increased, and is forecast to increase further, without the Government’s policy actions it estimates that 210,000 more Australians would be out of work by the end of this coming year.

Deficits, of course, need to be funded. The Budget anticipates a further \$60 billion in Treasury bond issues during the coming financial year, nearly doubling the value of Treasury bonds on issue. Only a few years ago the Treasury was seriously contemplating dismantling the Commonwealth Government Securities market. The significant reduction in the Government’s net debt raised questions as to the viability of the Government bond market. Now, Treasury’s Budget commentary notes that the new bond issuances will “enhance the liquidity and efficiency of the Treasury bond market.”

#### The bottom line

With any Budget there are winners and losers. In 2009 pensioners, carers, infrastructure contractors and the Defence portfolio came out in front. Tightening of eligibility for various Government rebates and concessions – including the private health insurance rebate – will mean the Budget has a measure of financial pain for others.

But in many respects the Budget messages were positive. As the effects of the global financial crisis continue to play out, many commentators have foreshadowed for Australia a long and protracted recession. Treasury forecasts are more optimistic. The Budget anticipates the economy rebounding with growth of 2.25 per cent in 2010-11, and positively rocketing ahead at 4.5 per cent growth over the balance of the Budget forecast period to 2012-13.

Driving growth is a \$22 billion increase in public infrastructure investment. Roads, ports, rail and broadband are all covered in the Budget, though there are questions as to how quickly the Government will – or can – convert these proposals into on-the-ground spending. The Budget also continued the Government’s policy emphasis on clean energy and renewables with a \$4.5 billion Clean Energy Initiative. The Government will be hoping that these and other Budget initiatives are enough to keep the economy ticking over until the worst of the global downturn passes.

# Business taxation

## Legislative fix to potential CGT problem for managed investment trusts

The Federal Government has announced special capital gains tax rules for managed investment trusts (MITs).

The announcement has a long history, and results from:

- A proposal by the Australian Taxation Office (ATO) to issue a draft ruling which would have considered whether investments by the trustee of a MIT were on capital or revenue account.
- The release in October 2008 of a Board of Taxation Discussion Paper, *Review of the tax arrangements applying to Managed Investment Trusts*, and subsequent submissions made to both the Board and directly to the Government.

The Government will implement the Board's interim advice to allow MITs to make an irrevocable election to apply the Capital Gains Tax (CGT) regime to "eligible assets" (generally shares, units and real property). Where such an election is made, resident investors will be entitled to the CGT discount on eligible taxable gains distributed by MITs. Non-resident investors will be exempt from Australian tax on distributions of gains on disposal of eligible MIT assets unless the assets are taxable Australian property.

The measure will apply to Australian MITs and unit trusts that are 100 per cent owned and controlled by MITs, and meet the eligible investment business rules in Division 6C of the *Income Tax Assessment Act 1936*. The measure will not apply to public unit trusts or corporate unit trusts which are taxed like companies.

If a MIT makes an irrevocable election to apply the CGT regime, the election will apply to all disposals of eligible investments in the first income year that commences on or after the 2008-09 income year. The Government indicated that this will reduce the incentive for MITs to dispose of existing assets and claim deductions for losses on revenue account against other income before the measure is implemented or an election is made.

Treasury will release a consultation paper on this measure shortly.

The Board is continuing to review the taxation treatment of MITs and is expected to provide its final report by mid-2009.

## Off-market share buy-backs

The Government will implement the recommendations of the Board of Taxation's review of the taxation treatment of off-market share buybacks. This will take effect for off-market share buybacks undertaken after the date of Royal Assent of the amending legislation.



To implement the Board's recommendations, the Government will introduce legislation to:

- establish a self-executing specific provision to debit the franking account of a company that undertakes an off-market share buy-back to cancel the tax benefit of streaming imputation credits from non-resident to resident shareholders
- deny notional losses to shareholders that participate in off-market share buy-backs conducted by listed companies
- modify for listed companies, the income tax law to specify the basis for determining the capital/dividend split, extend the period of lodgment for a distribution statement for a company conducting an off-market share buy-back, and confirm that certain integrity rules do not apply to tender style off-market buy-backs, and
- transfer the share buy-back provisions from the *Income Tax Assessment Act 1936* to the *Income Tax Assessment Act 1997*.

The Government has also endorsed the Board's recommendation that the ATO remove the "14 per cent administrative cap" on the level of discount for off-market share buy-backs undertaken by listed companies and that ATO should continue to provide guidance on market valuations for unlisted companies.

Amending legislation will be introduced as soon as practicable. Consultation will be conducted on the design of the amendments (details to be released on the Treasury website by the end of May 2009), followed by consultation on an exposure draft of the legislation.

#### Changes to the attribution regimes

The Government has released the Board of Taxation's review of the foreign source income anti-tax-deferral (attribution) rules (ie the controlled foreign company (CFC) rules, foreign investment fund (FIF) rules, transferor trust rules and the deemed present entitlement rules) and has announced that it will implement most of the Board of Taxation's recommendations.

To implement the Board's recommendations, the Government will:

- retain the CFC provisions as the primary set of rules designed to counter tax deferral arrangements including:
  - the provisions will be modernised by updating the definitions of what constitutes "active" and "passive" income and the base company income rules ("tainted sales income" and "tainted services income") will be removed
  - the existing exemptions within the CFC rules will be retained, including the listed country and Australian financial institution subsidiary exemptions, and additional exemptions introduced for complying superannuation entities
  - a choice of attribution methods will apply (branch-equivalent calculation, market value, and deemed rate of return) to calculate attributable income, and
  - the CFC provisions will be rewritten in the *Income Tax Assessment Act 1997*.
- repeal the FIF rules and replace them with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds. In the absence of FIF rules, closely held fixed trusts will be brought into the rewritten CFC rules where needed to prevent deferral

- the deemed present entitlement rules that apply in respect of non-resident trusts will be repealed, and
- the transferor trust rules will be retained with amendments to enhance their effectiveness and improve their integrity.

The Board's recommendation for a listed public company exemption from the attribution rules will not proceed.

The measures will apply with effect for income years commencing on or after Royal Assent of the amending legislation.

The Government has already commenced consultation on the implementation of the reforms with the release of a Treasury Discussion Paper on Budget night. Closing date for submissions is 9 June 2009. A future Special Edition of PricewaterhouseCoopers *TaxTalk* will review the Board's report and recommendations and the Treasury consultation paper.

### Changes to the thin capitalisation rules for ADIs

The Government is to introduce changes to the thin capitalisation rules of the tax law as they apply to approved authorised deposit-taking institutions (ADIs). These rules are a tax integrity measure designed to ensure that multinational enterprises do not allocate an excessive amount of debt to their Australian operations. This is achieved through disallowing a proportion of otherwise deductible expenses where the debt used to fund the Australian operations exceeds prescribed limits.

A statement by the Assistant Treasurer outlining the proposal stated that the changes will clarify how treasury shares, the previous business insurance asset known as excess market value over net assets and capitalised software costs will be recognised under the thin capitalisation rules. Additionally, the changes will take into account the views expressed by 'stakeholders' in relation to how the Australian equivalents (AIFRS) of the International Financial Reporting Standards apply to certain thin capitalisation arrangements for ADIs.

It is intended that the proposed changes will have effect from 1 January 2009, being the date that current transitional provisions in the tax law, which provide relief to affected entities from the impact of the adoption of AIFRS in 2005, generally expire.

### Extension of TFN withholding to closely-held trusts

With effect from 1 July 2010, the current tax file number (TFN) withholding arrangements will be extended to closely-held trusts (trusts that generally have fewer than 20 beneficiaries), including family trusts. TFN withholding arrangements already apply elsewhere in the tax law, for example to dividends, interest and unit trust distribution entitlements. Where a TFN is not provided by a beneficiary of a closely held trust before the beneficiary receives an assessable distribution, the trustee will be required to withhold an amount from the assessable distribution at the top marginal tax rate. When a beneficiary lodges their tax return, they will be able to claim a credit for the tax withheld from the distribution.

Withholding will not be required where the trustee of the trust pays tax on behalf of certain beneficiaries, such as in the case of minors.

### CGT roll-over for fixed trusts with same beneficiaries

For CGT events happening on or after 1 November 2008, a limited CGT roll-over will be introduced for assets transferred between trusts that have the same beneficiaries with the same entitlements and no material discretionary elements (that is, for trusts that are often referred to as fixed trusts).

The transfer of assets from one trust to another would normally trigger a CGT taxing event. This measure will allow trustees of eligible trusts to defer the CGT consequences of the asset transfer until the receiving trust subsequently deals with the asset.

The measure will be accompanied by appropriate integrity rules. For example, beneficiaries of the trusts will be required to adjust the CGT attributes of their interests in the trusts to take account of the transfer.

The abolition of the “trust cloning exception” (announced by the Government on 31 October 2008, refer to our December 2008 edition of *TaxTalk*) and the CGT roll-over for fixed trusts will be combined into one set of amendments. Legislation to give effect to the measures will be introduced as soon as practicable and an exposure draft released for consultation in the coming weeks.

### Business tax collections – The canary in the coalmine...

For those interested, 28 July 2009 will be a crucial date in testing the accuracy of tax revenue forecasts in the Budget.

In March 2009, the ATO wrote to Australia’s largest companies, requesting a meeting at CFO level to discuss the effect of the Global Financial Crisis on current and expected tax payments. No doubt the ATO findings have found their way into Budget projections.

But 4th quarter PAYG instalment payments – due by 28 July – will provide business taxpayers with a key opportunity to vary their instalments by reference to data based on business conditions for the whole of 2008-09. “Cash is king” at the moment, and failure to focus on PAYG instalment variations can mean that overpaid tax cannot be recovered from the ATO until lodgment of the 2009 income tax return, which typically occurs months later.

As part of our of year end planning discussions, PricewaterhouseCoopers will be working closely with clients to obtain an accurate indication of the scope for PAYG instalment variations.

### Enhanced tax break for small business investment

The Government will enhance the Small Business and General Business Tax Break which was announced on 13 December 2008 and is yet to be passed into law.

Under the originally proposed ‘tax break’ concession (also referred to as the investment allowance) the deduction able to be claimed by business taxpayers in respect of the GST-exclusive cost of acquiring or constructing new tangible depreciating assets, or for enhancing existing assets, required the ‘investment commitment time’ to be no later than 30 June 2009 for the taxpayer to be in a position to claim a deduction equal to 30 per cent of that cost. Generally, the further requirements for this deduction to be available at the originally proposed 30 per cent rate were:

- cost exceeded the minimum expenditure threshold (generally calculated on an asset by asset but with a limited aggregation concession) and
- asset be used by the taxpayer in the Australian business or installed ready for use by 30 June 2010.

In the case of ‘small business entities’ the minimum expenditure threshold is \$1,000. Otherwise it is \$10,000. Under the original proposal the 30 per cent rate could not be obtained because the asset was not used or installed ready for use by 30 June 2010, a lower 10 per cent rate was to apply if the asset was used or installed ready for use by 31 December 2010.

In order to assist ‘small business’ (which generally is where ‘annual turnover’ is under \$2 million), the Treasurer announced as one of the Budget measures that these taxpayers will be able to claim the ‘tax break’ deduction (which is in addition to the usual deduction for depreciation) at the rate of 50 per cent of the cost of eligible assets acquired between 13 December 2008 and 31 December 2009, and installed for use by 31 December 2010.

With these proposed changes to the ‘tax break’ concession, the deduction able to be claimed by reference to the cost of qualifying expenditure is set out in Table 4.

Table 4: Tax break (investment allowance)

Business entity	Investment commitment time (inclusive)	Date of first use or installed ready (inclusive)	Rate
Small business	13 December 2008 to 31 December 2009	By 31 December 2010	50%
Other business	13 December 2008 to 30 June 2009	By 30 June 2010	30%
Other business	1 July 2009 to 31 December 2009*	Between 1 July 2009 and 31 December 2010	10%

\* Based on the Government’s Budget night press release, the 10 per cent rate does not apply where the investment commitment time is between 13 December 2008 and 30 June 2009, and the asset is first used after 30 June 2010. This position is contrary to the Bill currently before Parliament, and will need to be clarified during the passage of the legislation through Parliament.

### Capital allowances – technical changes

The Government proposes to make 28 individual technical amendments to the capital allowance provisions to correct minor deficiencies in their current application and to improve certainty.

Several of these proposals have specific relevance and application to the mining sector. This includes amendments to some of the rules which can apply to the transfer, disposal or extension, renewal and conversion of mining rights. They also prevent assets, costing less than \$1,000 that are first used in exploration or prospecting, from being allocated to a low-value pool.

There will be a specific amendment to ensure that the definition of a depreciating asset will include all the components of “plant” as defined under the previous law.

Other amendments may affect the application of the capital allowance provisions to certain sale and leaseback arrangements. The amendments also include refinements to the project pool and software development rules, and the interaction with the capital gains tax and hire purchase rules.

The majority of these measures are proposed to take effect from 1 July 2009, but there are some that are proposed to take effect from the commencement of the current uniform capital allowance regime, that is from 1 July 2001. The Government has indicated that it will undertake a consultation process to assist with the development of the applicable legislation.

### Life insurance and exempt annuity business

The Government plans to introduce legislation to clarify, with effect from 1 July 2002, that the non-assessable non-exempt income of life insurance companies includes income from assets that support immediate annuity policies that satisfy the pre-July 2000 immediate annuity conditions.

In addition, the annuity conditions will not apply to annuity policies that are superannuation income streams, with effect from the 2007-08 income year.

Treasury has released a consultation paper on the design of the relevant amendments and comments can be made by 12 June 2009.

### Petroleum resource rent - offshore exploration incentive extended

Businesses that undertake offshore petroleum exploration will be able to take advantage of a one year extension of the incentive which provides a 150 per cent upfront deduction for exploration expenditure in prescribed remote locations, known as designated offshore frontier areas (DFAs), for another year. The one year extension will allow this incentive to apply to the 2009 annual offshore acreage release, which will be announced in June.

This incentive will be assessed in light of the final report of the Australia's Future Tax System Review and the Energy White Paper, which are both scheduled to be completed by the end of 2009.

## Personal taxation

Although the Treasurer announced no changes to the tax cuts which were enshrined in law after the last Federal Election, the tax rate reductions for high income earners will be offset by reduced superannuation contribution limits and the means testing of the private health insurance rebate.

The current legislated tax rates are set out in Table 5, which highlights the legislated tax rate reductions in the relevant income bands. Table 6 shows the comparison in dollar terms.

Table 5: Personal income tax cuts – current law

Tax threshold Income range (\$)	Tax rates already law		
	2008-09 %	2009-10 %	2010-11 %
0 – 6,000	0	0	0
6,001 - 34,000	15		
6,001 - 35,000		15↓	
6,001 - 37,000			15↓
34,001 - 80,000	30		
35,001 - 80,000		30↓	
37,001 - 80,000			30↓
80,001 - 180,000	40	38↓	37↓
180,001+	45	45	45

- Rates shown relate to resident adult individual taxpayers. Excludes Medicare levy and any tax offset entitlements
- ↓ Indicates an income range where some or all individuals will benefit from a tax rate reduction, compared to the prior year. For tax rates already enshrined in the law, the 2008-09 year is used as the base year for comparison purposes.

Table 6: Personal income tax cuts – comparison chart\*

Taxable income (\$)	2008-09 (\$)	2009-10 (\$)	2010-11 (\$)
50,000	9,000	8,850	8,550
75,000	16,500	16,350	16,050
100,000	26,000	25,450	24,950
150,000	46,000	44,450	43,450
200,000	67,000	64,850	63,550
300,000	112,000	109,850	108,550
400,000	157,000	154,850	153,550
500,000	202,000	199,850	198,550
600,000	247,000	244,850	243,550
700,000	292,000	289,850	288,550

\* Amounts shown relate to resident adult individual taxpayers. Excludes Medicare levy and any tax offset entitlements.



### Employee share schemes – tax to be paid “upfront”

The Budget will remove the ability under employee share scheme rules to defer the taxing point for “qualifying” shares or rights issued at a discount.

The current provisions provide a choice for an employee to pay tax on the discount “upfront” (ie in the income year they acquire the shares or rights). However in the absence of this election, the taxing point is deferred until “cessation time” occurs. This is typically when disposal restrictions cease or forfeiture conditions expire. The tax deferral reflects normal commercial practice for employee share schemes, whereby:

- employers seek to obtain commercial benefits before the shares or rights vest in the employee (eg the employee must remain with the company for a minimum period, specified targets must be achieved etc), and
- employees can:
  - gauge whether to take up their shares or rights, a decision based in many cases on whether the shares or rights have gained in value, and
  - delay paying tax until they enjoy full ownership rights over the asset, and (if necessary) the asset can be liquidated to help pay the tax liability.

The Government considers that an inconsistency exists between the two types of employee share schemes (ESS): qualifying shares schemes and non-qualifying share schemes.

The current rules provide two ways for an employee in a qualifying share scheme to have tax on the discount assessed:

- The employee can elect to be assessed in the income year the shares or options are acquired, and access an upfront tax exemption of up to \$1,000 on discounts received each year.
- If an election is not made, taxation of the discount is deferred until a specified later time (such as when the employee disposes of the share).

In comparison, if the shares or options are issued under a non-qualifying scheme, the employee is taxed on the discount when they acquire the shares or options. This means they do not enjoy the tax benefits associated with qualifying employee share schemes.

The Treasurer said it appears that some taxpayers are able to avoid paying tax on the discount by using the deferral method of assessment and then not declaring the discount at the appropriate time.

Under the new arrangements, all discounts on shares and options provided under an ESS – either qualifying or non-qualifying – will be assessed in the income year in which they are acquired. That is, employees acquiring shares or options under qualifying ESS will no longer be able to elect to defer taxation on their discount to a later time.

The Government’s aim is to ensure that all forms of remuneration are taxable in the year the remuneration is received.

The Government will also limit access to the \$1,000 upfront concession to those employees with a taxable income of less than \$60,000 (after adjustment for fringe benefits, salary sacrifice and negative gearing losses). The Treasurer said this will help ensure that tax concessions better achieve their objective of boosting the availability and take-up of ESS by low and middle income employees.

All of these measures will apply to shares and options acquired after 7.30pm 12 May 2009. The measures will not affect shares or options already held by employees.

While the Government states that it fully appreciates the benefits provided by employee share scheme arrangements, it believes these benefits must be balanced against the need to provide equitable outcomes for all employees.

Employee share schemes are put in place for various reasons which differ between companies and employees generally. The key components of a remuneration plan of both incentives and retention must also be balanced by the costs of the plan. Alternatives will need to be considered. For example, loan funded plans and “phantom” plans which are often used as an adjunct to equity plans.

The measures, if proceeded with in their current form, would also impact the ability of Australian companies to attract foreign talent. It can be expected that there will be consultation over alternative options to be shared with the Government.

#### Changes to private company deemed dividend rules

Currently under the private company deemed dividend rules, an assessable deemed dividend can arise where a private company transfers property to a shareholder or an associate for inadequate consideration. The provision however requires there to be a transfer of property.

In a measure designed to promote fairness in the tax system, the Government has now announced that, from 1 July 2009, it will extend the operation of this deemed dividend rule to cover circumstances where a shareholder (or their associate) is permitted to use a company asset such as real estate, a car or boat for free or at a discounted rate.

Additionally the Government has announced that these private company deemed dividend rules will be amended to ensure that corporate limited partnerships (which are taxed as companies under the tax law but which are not private companies) cannot be used to circumvent these rules.

Other technical amendments to the rules are also to be made to strengthen their operation (although these have not been specified).

#### Better targeting the income tax exemption for Australians working overseas

Australian residents working overseas for over 90 consecutive days are eligible for a general exemption under s23AG of the *Income Tax Assessment Act 1936*. This means they do not pay any Australian income tax on their foreign employment income.

This general exemption was provided to ensure that foreign employment income was not double taxed, first in the country where the income was earned and then again in Australia.

The Government says many foreign countries are lower tax jurisdictions which means some Australians who earn income overseas are paying much less tax than if they earned income solely in Australia. In addition, workers can use the general exemption to lower their taxable income for the purposes of accessing a range of government benefits.

The Government will amend the general exemption to provide a better targeted exemption which is only available for income earned:

- as an aid or charitable worker employed by a recognised non-government organisation
- as a government aid worker, or
- as a specified government employee (for example, defence and police force personnel deployed overseas).

To avoid Australians paying double-taxation, a tax offset will be available for any foreign tax paid on their foreign employment income.

Treasury will undertake stakeholder consultations concerning the legislation and administrative arrangements for these changes which will, in particular, affect employers of “rotational assignees” as well as traditional short/long term assignees overseas.

Further, income earned by an individual employed on an overseas project, approved by the Minister for Trade as being in the national interest, will remain exempt, as provided for by existing rules in s23AF of the Income Tax Assessment Act 1936.

#### Tax rebate for holders of private health insurance – Medicare levy surcharge

The private health insurance tax rebate is currently available for a percentage of the premium paid to a registered health insurer for a complying private health insurance policy. The percentage available is determined by the age of the oldest person covered by the policy (30 per cent where aged less than 65 years).

The current rebate is not means tested. This will change as a result of the Budget with effect from 1 July 2010.

At the same time, the Medicare levy surcharge (currently 1 per cent of taxable income and reportable fringe benefits) will increase under a “carrot and stick” approach. This is designed to encourage high income earners to keep their private health insurance cover.

Table G summarises the new approach. There will be no change to current arrangements for low and middle income earners who fall below the Tier 1 income thresholds referred to in the table.

### Medicare benefits — capping extended Medicare safety net benefits for items with excessive fees

The Government will introduce a cap on Medicare benefits payable under the Extended Medicare Safety Net for a range of items with “excessive” fees. These include all assisted reproductive technology items, all obstetric items and some ultrasound items related to pregnancy, the treatment of varicose veins, hair transplants and a cataract surgery item. The caps will take effect from 1 January 2010.

**Table 7: New private health insurance rebate and Medicare surcharge arrangements**

Category	Singles earning more than (\$)	Couples earning more than (\$)	Private health insurance rebate	Medicare levy surcharge if no insurance
Tier 1	75,001	150,001	<ul style="list-style-type: none"> <li>• 20% up to 65 years of age</li> <li>• 25% for those over 65 years</li> <li>• 30% for those over 70 years</li> </ul>	1%
Tier 2	90,001	180,001	<ul style="list-style-type: none"> <li>• 10% up to 65 years of age</li> <li>• 15% for those over 65 years</li> <li>• 20% for those over 70 years</li> </ul>	1.25%
Tier 3	120,001	240,001	0%	1.5%

### Medicare levy low income thresholds increased

From the 2008-09 income year, the Medicare levy low income thresholds will be increased to \$17,794 (from \$17,309) for single people, and to \$30,025 (from \$29,207) for those who are members of a family. The additional amount of threshold for each dependent child or student will also be increased to \$2,757 (from \$2,682).

The Medicare levy low-income threshold for pensioners below pension age will also be increased. From 1 July 2008, the threshold will rise to \$25,299 (from \$22,922). This increase will ensure that pensioners below pension age do not pay the Medicare levy while they do not have an income tax liability.

### Tightening access to non-commercial business losses

The Government will tighten the non-commercial loss rules which it says allows individuals to claim tax deductions for non-commercial business activities against their other income. The Government gives examples of activities which it says are no more than hobbies or lifestyle choices and even those that have business-like characteristics are often unlikely to ever make a profit and do not have a significant commercial purpose or character.

The measure will ensure excess deductions from unprofitable business activities cannot be used to reduce salary, wage and other income of high income earners by tightening the application of the non commercial losses rules. Taxpayers with an adjusted taxable income of over \$250,000 will instead have excess deductions quarantined to the business activity.

Taxpayers may still apply to the Commissioner for relief if there are exceptional circumstances or because the nature of the activities means that, a taxpayer is temporarily carrying on an uncommercial business but the activities are nonetheless independently assessed as commercially viable.

The measure will apply from the 2009-10 year of income.

### Entrepreneur's tax offset

The income test for the entrepreneur's tax offset (ETO) announced in the 2008-09 Budget will be deferred for 12 months until the 2009-10 financial year.

The deferral ensures that the timing and nature of the income test is consistent with the Government's broader income testing reforms.

The ETO provides a 25 per cent tax offset on the income tax liability of small businesses that have an annual turnover of \$75,000 or less, phasing out from a turnover of \$50,000.

### Family payments

Family Tax Benefit Part A (FTB-A) payment rates will be indexed by the Consumer Price Index from 1 July 2009. Currently, maximum rates of FTB-A for children under the age of 16 are benchmarked to a proportion of the combined couple rate of pension payment, or adjusted by the Consumer Price Index, whichever is higher.

The higher income thresholds for family payments will be maintained at their current level until July 2012 rather than being indexed by the Consumer Price Index.

The following higher income thresholds will remain fixed until 2012:

- the Family Tax Benefit Part B primary earner income threshold will remain at \$150,000
- the income threshold for receiving the dependency tax offsets will remain at \$150,000
- the Baby Bonus eligibility threshold will remain at \$75,000 of family income in the six months following the birth or adoption of a child, and
- the higher income-free area of FTB-A will remain at \$94,316 of family income (plus \$3,796 for each child after the first).

### Special disability trusts

With effect from the 2008-09 income year, the unexpended income of a special disability trust will be taxed at the relevant beneficiary's personal income tax rates rather than automatically at the top personal tax rate plus the Medicare levy.

With effect from the 2009-10 income year, the Government will extend the capital gains tax main residence exemption to include a residence that is owned by a special disability trust and used by the relevant beneficiary as their main residence.

### First home owners “boost” extended

The Government will extend the First Home Owner’s Boost (FHOB) for an extra six months but will reduce the benefit by half for the last three months of the extension period.

For eligible first home buyers entering into contracts between 1 July 2009 and 30 September 2009 (inclusive), the FHOB will continue to provide \$7,000 for the purchase of established homes and \$14,000 for the purchase of new homes.

This means that including the \$7,000 First Home Owner’s Grant, until 30 September, purchasers of new homes will continue to be eligible for \$21,000 of assistance. Purchasers of existing homes will continue to be eligible for \$14,000 of assistance.

Between 1 October 2009 and 31 December 2009, the FHOB grants will be \$3,500 for the purchase of established homes and \$7,000 for the purchase of new homes.

This means that including the \$7,000 First Home Owner’s Grant, from 1 October until 31 December, purchasers of new homes will be eligible for \$14,000 of assistance, and purchasers of existing homes will be eligible for \$10,500 of assistance.

The FHOB grants are in addition to the existing \$7,000 grant under the First Home Owners Scheme.

### New ‘Work Bonus’ for age pensioners

From 20 September 2009, only half of the first \$500 of an age and service pensioner’s employment income, earned per fortnight, will be assessed under the income test.

This means up to \$250 of earnings a fortnight will be excluded from means testing.

Submissions to the Harmer Review highlighted the need to make it easier for age pensioners to keep money they earned from employment. The Government expects about 75,000 age and service pensioners to benefit from the new Work Bonus.

The Pension Bonus Scheme will close to new entrants from 20 September 2009. Existing members of the scheme will continue to accrue entitlements under existing rules. The Government believes the vast majority of participants would have continued in the workforce in the absence of the scheme.

### Reversal of income test for Commonwealth Seniors Health Card

A measure announced in the 2008-09 Budget to include gross tax-free superannuation pension income in the adjusted taxable income test for the Commonwealth Seniors Health Card will not proceed.

However, the measure to include income that is salary sacrificed to superannuation in the income assessment will proceed from 1 July 2009.

### Social security agreements with Latvia, the Czech Republic and the Slovak Republic

The Government will extend the current network of reciprocal social security agreements to include Latvia, the Czech Republic and the Slovak Republic.

These agreements are expected to commence on 1 January 2011 and will improve access to the Age Pension for people who live for a time in both Australia and the nations who are party to the agreements. Australia and these nations will share responsibility for the pension, each paying a proportion of their pension based on relevant eligibility criteria and the period of residence or insurance that recipients have accrued in each country.

These agreements also deal with 'double coverage' of superannuation by removing the obligation for an employer to make compulsory superannuation or social security contributions in two jurisdictions in respect of the same work done by the same employee sent to work in the other jurisdiction. The employer's superannuation (or social security) obligation will instead remain in the employee's home country.

### Is Australia's personal tax system future proof?

An analysis by PricewaterhouseCoopers of Australia's personal tax system, viewed in combination with other factors such as an aging workforce and globalisation, indicates that:

- Australia's maximum rate, together with the top personal tax rate threshold as a multiple of average wages, will need to remain competitive with comparable countries competing for globally mobile labour, entrepreneurs and investors.
- Changes may be needed in our tax mix (the extent to which our nation extracts tax from labour, as distinct from capital and consumption) to reduce reliance on personal income tax.
- Given limits on the Government's ability to provide pensions and other benefits, the personal tax system needs to encourage greater self reliance by allowing funds for typical life events (first home, education, illness etc) to be set aside in low taxed saving accounts, operating outside the superannuation system.
- The days of lodging personal tax returns and claiming deductions and tax offsets may be drawing to an end for individuals with straightforward tax arrangements (eg employees with some interest and dividend income). The spiralling cost to revenue of work related deductions, plus compliance costs, support calls for greater use of the PAYG withholding system for collecting tax from such taxpayers.

These issues have been raised in the PricewaterhouseCoopers' submission to the Henry Tax Review. For a copy of the submission, contact Tim Cox, Partner, on (03) 8603 6181 or [tim.cox@au.pwc.com](mailto:tim.cox@au.pwc.com)

## Tax reform update

- Submissions on the December 2008 Consultation Papers – dealing with pensions and tax matters – have now been lodged.
- The PricewaterhouseCoopers' tax submission calls for:
  - An internationally competitive business tax system, with the focus on obtaining the maximum reduction in the corporate tax rate rather than narrowing the base of taxation.
  - A significantly reduced number of taxes on business, both in terms of taxes imposed on business and taxes that business collects on behalf of government. Harmonisation of the remaining State taxes should be a key priority.
  - A less complex tax system. Suggestions include greater reliance on accounting data, a reduction in specific anti-avoidance rules, and simplification of the current income tax law into one Assessment Act.
  - In the absence of any tax policy changes relating to current tax related adjustments (eg non-assessable or non-deductible items), at this stage we do not see radically different bases for taxation of business income (eg a move to a cash flow basis for business taxation) as being appropriate.
  - Caps on interest deductibility need to be the subject of further modelling and analysis before any decision is made on their suitability in an Australian context.
  - We acknowledge the arguments for and against retention of the dividend imputation regime in its current form, but believe that no decision can be made in the abstract without taking into consideration the overall re-design of the tax system which will emerge from the Panel's recommendations. These design issues include the tax concessions afforded to inbound and outbound investors, tax rates, changes to the company tax base, and new incentives provided to individuals to save and invest.
  - Fringe benefits should be taxed in the recipient's hands and we recommend that a number of improvements be made to the FBT system.

On personal tax matters, our submission:

- Put forward a model in which individuals with relatively straightforward tax affairs need not lodge income tax returns. This would involve expanded domestic withholding tax arrangements, changes to PAYG withholding, and some compensating concessions (eg a limited personal allowance).
- Supported the introduction of tax effective saving mechanisms beyond superannuation to encourage individuals to make better provision for life events (eg major illness, education, first home, children etc).
- Questioned whether the personal tax system is the best delivery mechanism for transfer payments.

### The thoughts of Dr Henry, Chairman, Australia's Future Tax System Review

- *"I'm acutely aware of the extraordinary complexity in our system...I can probably take responsibility for some of that complexity. Even so...it was a revelation to me that Australia's system now has no fewer than 125 taxes." 12 November 2008*
- *"...an excessive level of complexity wastes resources. It makes it difficult for taxpayers and transfer payment recipients to make optimal decisions. It diverts resources from more valuable uses; many high-achieving tax agents could be school teachers, for example." 12 November 2008*
- *"...an open economy model [like Australia] affects the way one should think about our company tax arrangements, including dividend imputation. But I don't want to be interpreted as arguing the case for doing away with imputation." 23 February 2009*
- *"...the task of the review is...to look beyond the immediate downturn and to redesign our tax-transfer system to meet the profound demographic, social, economic and environmental challenges of the coming decades." 13 March 2009*
- *"...it seems to me to be a genuinely open question whether, in years to come, Australia should persist with state and territory revenue offices." 27 March 2009*
- *"...take company tax, which at first glance would be of most interest to wealthier Australians. Reducing it would seem to be inequitable. But there are strong arguments to the contrary. In the face of competition from countries with low company tax regimes, higher company tax rates could work to reduce overseas investment in Australia, which could reduce the number of jobs available, lower the demand for Australian workers and, in this way, lower wages." 3 April 2009*

- The next stage involves discussions with key industry, professional and community groups, and a two day tax policy conference to be held in June 2009.

For a copy of the submission, contact Tim Cox, Partner, on (03) 8603 6181 or [tim.cox@au.pwc.com](mailto:tim.cox@au.pwc.com)

## PricewaterhouseCoopers' contribution to the tax reform debate

Apart from our submissions to the Henry Tax Review, the firm has published three studies which are highly relevant to tax reform in Australia:

### [1. What is your Company's Total Tax Contribution? 2008 Survey Results](#)

This is the third survey conducted with the assistance of Australia's major companies, and examines the impact of Australia's tax system on business.

### [2. Review of Effective Tax Rates in Australia, August 2008](#)

While the statutory tax rate is a guide to the tax burden in Australia, the effective tax rate gives a greater insight into the tax base. Given the analysis in the Consultation Paper on base broadening and base narrowing measures, this study provides comparative country evidence that Australia has the lowest differential between the statutory and effective rate.

### [3. Paying Taxes 2009 The Global Picture](#)

A joint World Bank and PricewaterhouseCoopers review of the ease of paying taxes for small to medium domestic companies in 181 countries.

# Superannuation and retirement

## Superannuation contributions – deductions restricted

Less than two years after the introduction of simplified superannuation reforms with bipartisan support, the Treasurer has announced changes which will effectively halve the tax deductible contributions limit relevant to employers (for salary sacrifice arrangements for employees) and to the self employed.

Although cynics will point to the \$2.75 billion revenue saving as the more likely cause, the Government has justified the changes by reference to the Australia's Future Tax System (AFTS) Report on the retirement income system, released on Budget night. The report found that tax-assisted voluntary superannuation contributions should be more fairly distributed, and questioned whether the current cap on the concessions was appropriate.

The Government will therefore reduce the cap on concessional superannuation contributions from \$50,000 this year to \$25,000 from 1 July 2009. This cap will be indexed.

The other aspect of the policy change is particularly disappointing for those whose retirement plans relied on transitional rules, as part of the move in 2007 from age based contribution limits to fixed dollar contribution limits. The change has enabled higher deductible contributions (up to \$100,000) to be made during the financial years 2007-08 to 2011-12 by persons aged 50 and over on the last day of the relevant financial year. This transitional unindexed cap for concessional contributions for those in this age category will now be reduced – from \$100,000 to \$50,000 – for the 2009-10, 2010-11 and 2011-12 income years, after which affected persons will revert to the lower \$25,000 cap (or applicable indexed amount – see above).

The non-concessional (ie 'after tax') contributions cap will remain at \$150,000 for the 2009-10 financial year (or \$450,000 over three years). It will only increase when the new lower \$25,000 cap is increased by indexation.

## Superannuation co-contribution – reduced on a temporary basis

The Government will reduce the superannuation co contribution matching rate from 150 per cent to:

- 100 per cent for contributions made in the 2009-10, 2010-11 and 2011-12 income years, and
- 125 per cent for contributions made in the 2012-13 and 2013-14 income years.

The maximum co-contribution payable will also be reduced accordingly to:

- \$1,000 for contributions made in the 2009-10, 2010-11 and 2011-12 income years, and
- \$1,250 for contributions made in the 2012-13 and 2013-14 income years.

The co-contribution matching rate and maximum payable will return to 150 per cent and \$1,500 for contributions made in the 2014-15 and later income years.



### Will the preservation age be increased?

The Government has noted the following recommendation in the AFTS Report:

*“...the age at which Australians can access their superannuation (the preservation age) should be gradually increased to 67 years, subject to further examination of how mandatory retirement ages should be treated. This would complement the Government’s decision to adopt the report’s recommendation to increase the Age Pension age to 67 years.”*

It appears that a final decision on this issue will be deferred until the AFTS final recommendations on broader tax-transfer issues are received in a report expected in December 2009.

### Reduction in minimum pension draw-downs extended

In a welcome measure, the Government will halve the minimum amounts self-funded retirees have to draw down from their account-based pensions for 2009-10.

This extends the drawdown relief provided by the Government for 2008-09, recognising the impact of the global recession.

### Lost your super - find it before the Government does

From 1 July 2010, the Government will require superannuation providers to transfer certain lost superannuation accounts to unclaimed monies:

- accounts with balances less than \$200 (small accounts), and
- those which have been inactive for a period of five years and have insufficient records to identify the owner of the account (insoluble accounts).

Former account holders will still be able to reclaim their money from the Australian Taxation Office (ATO) at any time.

There are currently around three million lost accounts with balances less than \$200, and fund managers and active members are expected to benefit from lower compliance costs as a result of this measure.

These benefits aside, the measure will increase Government revenue by a handy \$230 million over three years.

# GST

## GST administration reforms

The Government will implement 41 of the 46 recommendations of the Board of Taxation review of the legal framework for the administration of the Goods and Services Tax (GST). The package of reforms is intended to reduce GST compliance costs, achieve greater standardisation between the GST and income tax regimes, reduce anomalies and streamline the GST administration framework.

According to the Assistant Treasurer's media release, the key components of the package include:

- harmonising the GST law and the income tax self-assessment regime and rulings regime
- adopting more principled and flexible GST grouping rules
- simplifying the GST adjustment provisions, including adjustments for changes in use, and
- reforming the GST treatment of sales of 'going concerns' and 'farmland'.

Other recommendations which have been accepted include:

- an option to treat certain business to business transactions as fully taxable (however this would not apply where the supply is wholly or partly input taxed)
- further examination of multi-party transactions in order to eliminate unrecoverable tax
- a review of the vouchers regime, and
- changes to the existing four year period of review so that it may be 'refreshed' in certain circumstances, and also the time limit for claiming input tax credits, with changes to the latter to apply from 7.30pm (AEST) on 12 May 2009.

Most significant changes will take effect from 1 July 2010.

In addition, Treasury will review the "margin scheme" provisions affecting property transactions and also the GST financial services provisions. They will determine if reforms can be made to simplify the operation of the legislation and reduce both compliance and administrative costs, whilst retaining the existing policy intent.

The Government has also asked the Board of Taxation to review the cross-border provisions of the GST law and to recommend changes that need to be made to ensure that cross-border transactions are treated in an efficient and effective manner. There will be a particular focus on design features which underpin the involvement of non-residents in the Australian GST system.

Those components of the package that represent a change to the GST base are subject to the unanimous agreement of the States and Territories.



### GST and representatives of incapacitated entities

In line with the Assistant Treasurer's announcement on 6 February 2009, the Government will amend the GST law, with effect from 1 July 2000, to ensure that a representative appointed over an incapacitated entity is liable for, or entitled to, the GST consequences that arise from actions the representative undertakes during its appointment.

For the purposes of determining the GST consequences for the representative, the Government will also ensure that the activities of a representative are treated as the activities of the incapacitated entity.

Following the recent decision of the Federal Court in *Commissioner of Taxation v PM Developments Pty Ltd [2008] FCA 1886*, these amendments are intended to restore the policy intention that representatives of incapacitated entities are liable for the GST payable, and for other requirements of the law, during the period of their appointment.

### GST and cross-border transport supplies

The Government will amend the GST law to:

- reduce GST compliance costs for domestic transporters and non-residents involved in the domestic transport of exported and imported goods by shifting the liability for paying GST on the domestic transport of imported goods from the transport service supplier to the importer. This will involve:
  - adding the cost of domestic transport into the “value of taxable importation” used to calculate the GST liability on importation, and
  - removing the GST liability on the supply of domestic transport services made to a non-resident
- improve consistency in the GST treatment of postal and containerised non-postal goods by amending the definition of “place of export” for containerised non-postal goods from the place of “containerisation” to the place from which the goods are sent, and
- assist sub-contracted transport suppliers with GST compliance, by making sub-contracted domestic transport services that are part of the domestic leg of an export transport service taxable/creditable, even though the goods may ultimately be for export.

The measures, which are subject to the unanimous agreement of the States and Territories, will take effect from 1 July 2010.

### GST treatment of Carbon Pollution Reduction Scheme units

Further to the package of exposure draft legislation on the Carbon Pollution Reduction Scheme (CPRS), released on 10 March 2009, the Government has confirmed that it will amend the GST law to clarify the GST treatment of CPRS units with effect from the introduction of the CPRS.

The changes ensure consistent GST treatment for all units recognised under the CPRS by treating eligible international units and all Kyoto units as personal property rights and not rights within the meaning of ‘real property’ for GST purposes.

## Other indirect taxes

### Taxation definitions of beer and wine

The Government will alter the taxation definitions of beer and wine to ensure that beer and wine-based products that attempt to mimic spirit-based products are taxed as spirit products. With effect from 1 July 2009:

- the definition of beer will be changed to ensure that beer has a certain level of bitterness, and to clarify that the addition of sugar, artificial sweeteners and spirits may cause the resultant product to be taxed as a spirit based product
- the definition of grape wine products will be changed to:
  - exclude products that add the flavour of any alcoholic beverage, other than wine, and
  - provide certainty as to the circumstances where alcohol can be added to a grape wine product.

### Export Market Development Grants – extra funding to guarantee full payment of entitlements

The Government has provided an additional \$50 million in 2008-09 for the Export Market Development Grants scheme, which provides small and medium-sized Australian businesses with taxable grants to reimburse a proportion of eligible export promotion costs.

The Minister for Trade has announced that the increase in funding will guarantee that exporters will receive 100 per cent of their eligible expenses for this year, to be delivered in grants in June 2009.

### Indirect Tax Concession Scheme – diplomatic and consular concessions

The Government has provided indirect tax refunds (including for GST) for the diplomatic and consular representation of certain countries under the Indirect Tax Concession Scheme, to take effect from the time specified in implementing determinations issued by the Minister for Foreign Affairs.

The new or upgraded concessions for diplomatic/consular representation affect fifteen countries.



# Research & Development - innovation

Following the release on 9 September 2008 of the Review into the National Innovation System -“venturousaustralia”, the Government has announced support for a number of measures initially set out in the Review. The intention is to simplify and enhance the current research and development (R&D) tax concession scheme by introducing the following initiatives:

- From 1 July 2010, the current concessional deductions will be replaced with an R&D tax credit, intended to cut red tape and incentivise businesses to invest in R&D.
- For companies with an annual turnover of less than \$20 million, there will be a 45 per cent refundable tax credit, equivalent to a 150 per cent tax concession (benefitting 5,500 companies). This equates to a cash saving of 15 cents for every dollar of R&D spend, and will be refundable where the company is in a tax loss position.
- For companies with a turnover of greater than \$20 million, they will have access to a non-refundable 40 per cent tax credit, equivalent to a 133 per cent tax concession. This equates to a cash saving of 10 cents for every dollar of R&D spend. This will also be available to companies undertaking R&D in Australia but where the intellectual property is held offshore.
- The 175 per cent premium concession and international premium concession which reward increasing R&D spend will be abolished.
- Eligibility criteria will be tightened to support “only genuine R&D”. Further consultation for developing legislation in relation to this will take place with a consultation paper to be released in the next few months.
- As a transitional measure prior to the introduction of the R&D tax credit, the R&D expenditure threshold for the R&D tax offset will increase from \$1 million to \$2 million for 2009-10, providing a demonstration of increased Government support for R&D by small companies during the global downturn.
- The reform of the R&D tax concession will complement the Government’s new \$196.6 million allocated over the next four years to establish a Commonwealth Commercialisation Institute.



Other funding measures announced in the 2009 Federal Budget include:

- The Clean Coal Fund and the Energy Innovation Fund will provide \$650 million of specific funds to accelerate the development and deployment of low emission and clean energy technologies. Initiatives include development of carbon mapping and infrastructure plan, research programs and development of 'clean' plants.
- The Renewable Energy Fund is a competitive grants program (\$500 million over six years) which will provide companies with between \$10 million and \$75 million to develop, commercialise and deploy renewable energy in Australia. Companies will be encouraged to contribute \$2 for every \$1 given to them by the Renewable Energy Fund.
- The \$4.5 billion Clean Energy Initiative (through Renewables Australia, Solar Flagships program and the Carbon Capture and Storage Flagships programs) introduced to support the development of low emissions coal technologies, new clean technologies and the growth of the clean energy generation sector, to help ensure 20 per cent of Australia's electricity comes from renewable sources by 2020.
- The existing Food Innovation Grants (FIG) program will no longer proceed. Savings of \$62.7 million over five years will be used to offset the cost of programs in priority areas for farmers and agriculture.

## Tax administration, integrity and design

Tax integrity remains high on the Government's agenda. Specifically, the Government will be taking steps to ensure that the tax law is able to effectively guard against individuals and businesses seeking to avoid their tax obligations. A discussion paper will shortly be released for comments about proposed options to consolidate, streamline and improve the operation of provisions designed to counter tax avoidance.

Funding in the order of \$595 million will be provided to the ATO over four years to support taxpayers experiencing difficulties meeting their tax liabilities. It will also tackle emerging revenue risks and promote community confidence in the tax system. Specifically, the Government has indicated that it is determined to keep taxpayers experiencing financial distress engaged with the tax system while addressing revenue risks which may arise as the Australian economy recovers and returns to growth.

According to the Assistant Treasurer's media statement, the funded measures are expected to raise additional net revenue of approximately \$1,383 million through enhanced compliance. The four measures for which the funding is to be provided are:

- early identification of businesses under financial stress and the provision of flexible tax payment arrangements
- investigating and prosecuting tax haven abuse (Project Wickenby)
- ensuring wealthy Australians (including high income company executives and directors) and large and medium sized businesses continue to meet their tax obligations as the Australian economy recovers, with a focus on cross-border financial arbitrage, profit shifting, treatment of gains and losses, and infrastructure and investment claims, and
- promoting a level playing field for small business by addressing the cash economy and unfair competitive practices.

### Review of tax elections

The Government has indicated that it will shortly release for public comment a discussion paper that proposes guidelines for the design of various election provisions within the income tax law. If the outcome of this review meets its objective of increasing consistency and reducing the uncertainty in the application of the framework for income tax elections, this should simplify one of the practical aspects of compliance with tax law. This announcement would seem to show an acceptance of a recommendation that arose out of the former Government's Review of Aspects of Income Tax Self Assessment.



### Review of unlimited amendment periods

As part of a process to simplify the tax law, the Government has announced that over 100 provisions in the income tax laws that currently give the Commissioner of Taxation an unlimited period of time in which to amend a taxpayer's income tax assessment, will be repealed. The repeal is expected to take effect from the date of Royal Assent of the enabling legislation (which has not yet been released).

No details have been released as to the provisions to be repealed, but presumably this decision follows the review that was commissioned by the former Government in August 2007. The Government considers that for those provisions to which the unlimited time period applies, the Commissioner of Taxation has sufficient time under the general amendment period provisions to review an assessment (generally a period of four years for corporate taxpayers).

### Tax law design

To assist in the implementation of the recommendations made by the Tax Design Review Panel, headed by PricewaterhouseCoopers Partner Neil Wilson, the Government will provide funding of \$1.8 million over three years to the Department of the Treasury. This will support the engagement of private sector experts to provide input on practical and commercial issues arising from proposed tax changes.

In addition, the Government has released a discussion paper seeking comments (by 10 July 2009) on the Panel's recommendation that consideration be given to allow the Commissioner of Taxation the power to modify the tax law to give relief to taxpayers. The Panel's recommendation followed concerns that the process of legislative amendments took too long to correct minor anomalies and unintended outcomes.

## Non-profit sector

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### Regular reviews of registers for deductible gift recipients

To improve the integrity of the tax system in relation to eligible cultural or environmental organisations, harm prevention charities and overseas aid organisations which currently receive tax deductible donations, the Government proposes to conduct triennial reviews of the applicable deductible gift recipient registers. The reviews will cover the guidelines for and the organisations that are listed on the applicable registers.

### Greater integrity to apply to charitable organisations

The Government has announced that the income tax law that applies to charitable organisations will be amended to ensure that Parliament retains the ability to fully scrutinise those organisations that seek to pass funds to overseas charities and other entities. This measure, which is the Government's response to the High Court decision in the *Word Investments* case, where the Court ruled in favour of the taxpayer and contrary to long standing ATO practice, will be subject to public consultation. Any amending law will not take effect until the enabling legislation receives Royal Assent.

In addition, the Government has asked Treasury and the ATO to keep a watching brief on the not-for-profit sector while the outcome of the Henry Review into Australia's future tax system and the Productivity Commission's inquiry into the contribution of the not-for-profit sector remain outstanding.



## Tax legislative pipeline

The economy may be quiet, but not so the world of tax. Apart from the Henry Tax Reform Review (see page 20), there are a range of legislative measures recently enacted, before Parliament, or on the way. Table 8 indicates some of the workload coming the way of readers who work on tax matters on a day to day basis.

Table 8: Tax measures in the pipeline

Measure	Status
Taxation of Financial Arrangements (TOFA) stages 3 and 4 - Division 230	Now law, and will apply to income years commencing on or after 1 July 2010 (with an option to early adopt from 1 July 2009). A range of issues have been raised with Treasury and ATO officials, and some amendments and clarifications are expected.  Action: Implementation planning (including impact of alternative tax timing methods available) should be on the agenda.
Investment allowance	Contained in the Tax Laws Amendment (Small Business and General Business Tax Break) Bill 2009, introduced into the House of Representatives on 19 March 2009.  The legislation will need to be amended in light of changes announced in the Budget.  A bonus deduction of 10, 30 or 50 per cent may be available for investment in eligible assets within specified timeframes.  Action: Model the impact of the investment allowance, and consider the optimal timing of capital expenditure for new, tangible depreciating assets and new expenditure on existing assets. Time critical.
Consolidation measures – including measures announced in 2007-08 Federal Budget, and on 27 October 2006, 1 December 2005, and 4 December 2003	On 28 April 2009, the Federal Government released draft legislation responding to some of the outstanding measures. Comments on the Exposure Draft: Tax Laws Amendment (2009 Measures No 4) Bill 2009 are due by 25 May 2009.  In some cases, the changes are beneficial to companies which have entered into consolidation and may result in tax refunds.  Action: Establish relevance to prior year consolidation calculations and gauge financial impact. Consider whether amendment of prior year tax returns required.
Foreign currency amendments	A retranslation methodology for intra group accounts in foreign currency is now available, due to a change in the definition of “qualifying forex account” now enacted.  Action: Retrospective election to adopt retranslation should be considered before 24 June 2009 deadline.  Other changes, announced in August 2004 and re-confirmed in last year’s Budget, have been the subject of recent consultations. These modifications rectify defects in the current law, and include compliance cost saving measures. The measures are to be back-dated to 1 July 2003. Legislation expected in the current Budget or Spring 2009 sittings.
Debt equity rules – treatment of term subordinated notes (impact of solvency clauses)	Draft regulation released for comment on 22 April 2009. Comments due by 22 May 2009.  Action: Review proposed changes, and make submissions if necessary.

## Paid parental leave

The Government has used the Budget to announce its long-awaited response to the Productivity Commission's final report: Paid Parental Leave: Support for Parents with Newborn Children.

Paid parental leave is expected to be of particular benefit to women working in industries with high numbers of female employees, where registered enterprise agreements currently indicate low levels of entitlements. Recent research by the University of Sydney indicates that those working in the retail and hospitality sectors have the lowest levels of maternity entitlements resulting from enterprise bargaining arrangements.

The broad details of the proposed scheme are as follows:

- The scheme will be available to parents for births and adoptions that occur on or after 1 January 2011. Parents will be able to lodge claims from 1 October 2010.
- The scheme will provide 18 weeks postnatal leave paid at the federal minimum wage (currently \$543.78 per week).
- To be eligible for the scheme, a parent in paid work must have:
  - worked continuously with one or more employers for at least 10 of the 13 months before the expected date of birth or adoption
  - worked at least 330 hours in those 10 months (equivalent to around one full day of work each week); and
  - an adjusted taxable income of \$150,000 or less in the financial year prior to the date of birth or adoption of the child.
- Employers will act as “paymasters” in most cases. The Government will provide employers with funds in advance of the payments they make to employees.
- Parents who are eligible for paid parental leave will be able to continue to access employer-funded leave around the time of the birth or adoption of a child. This will include employer-provided maternity leave and recreation leave. Government-funded paid parental leave can be taken in conjunction with, or in addition to, employer-provided paid leave.



- Paid parental leave will also be available to contractors, casual workers and the self-employed.
- Payments under the scheme will be taxable.
- Parents who receive paid parental leave will not receive the Baby Bonus (except in the case of twins or multiple births), or Family Tax Benefit Part B during the 18 week Paid Parental Leave period.
- Mothers and primary carers not in full-time paid work will continue to receive the current forms of family assistance (including the Baby Bonus), if they meet the relevant eligibility requirements.

In line with a recommendation by the Productivity Commission, superannuation payments will not initially be introduced, but this issue will be considered as part of a comprehensive review of the scheme within three years of implementation.

Due to the global economic downturn, consideration of the recommended paternity leave has also been deferred to the review.

## Further information

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