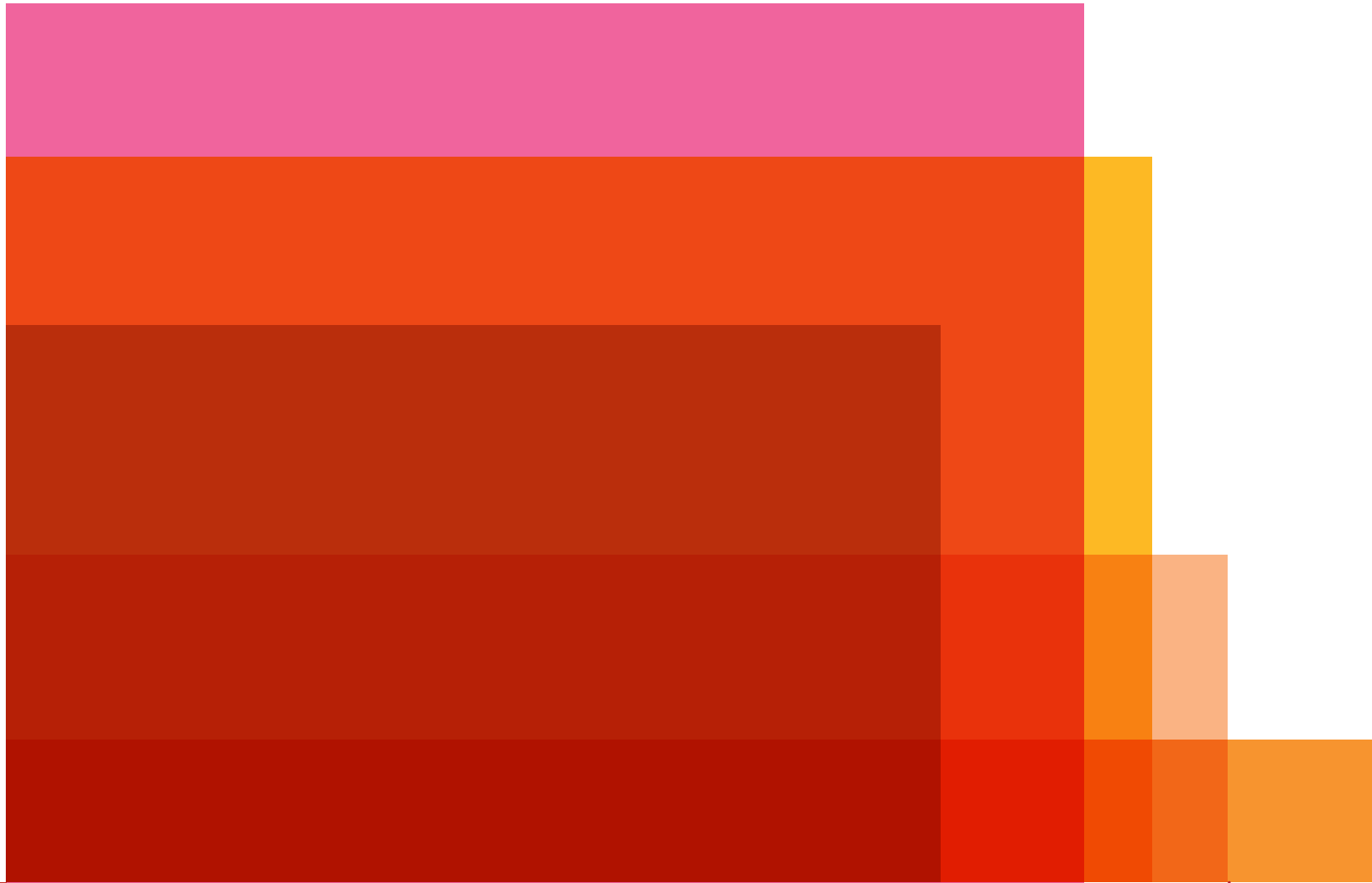


11 May 2011

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What would you like to grow?



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Australian Federal Budget 2011-12 analysis

From an economic perspective, Australian business is recovering from the global financial crisis. As businesses seek to stabilise financially in a recovering economy, the impacts of inefficiencies in the tax system on Australia's competitiveness and business agility are magnified – and while there were some budget sweeteners announced, the focus of this year's budget is on spending cuts aimed at returning the budget to surplus in 2012-13.

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Over the last two years, the tax reform agenda has moved ahead. The Australia's Future Tax System review completed its recommendations in December 2009 and a small number of these recommendations, notably the resources tax, have been adopted by the Government and also announced in this year's budget. The broader tax reform agenda was not pursued in the budget and will probably take many years to unfold. Business and other sectors of the community remain hopeful that the October 2011 Tax Forum will revitalise the debate and provide it with fresh impetus.

Infrastructure

Reforms to promote private investment in infrastructure

The Government announced measures which are stated to remove impediments in the tax system to invest in infrastructure projects of national significance. Broadly, these measures will:

- uplift project losses associated with “designated infrastructure projects” at the Government bond rate, and
- exempt project losses from the continuity of ownership test and the same business test.

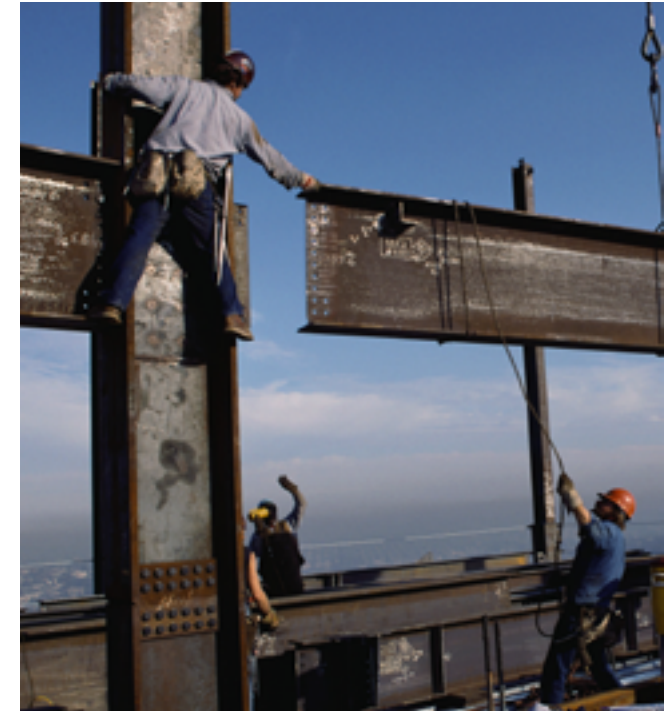
Due to the nature of infrastructure projects, there is often a significant gap between the commencement of the relevant infrastructure project and the recoupment of losses generated in the early years. Under the current tax rules, changes in ownership of the project vehicle can result in tax losses being lost. The proposed changes are aimed at ensuring that tax losses maintain their value over time, and are able to be recouped even where there is a change in ownership of the project vehicle.

What is not clear, is whether this proposal will be restricted to companies. If this is the case, the removal of the same business test may not be of much assistance as most project companies are special purpose companies. In the event that the proposal extends to include trusts, the measure will be of more assistance.

The proposal to index early year losses may be of benefit to project economics as it may defer the taxing point of the project and allow for more borrowings.

A decision maker will be empowered to confer “designated infrastructure project” status to privately financed public infrastructure projects of national significance based on a range of criteria. These criteria are yet to be determined, but will include a global expenditure cap of \$25 billion over the period from the date of enactment of the enabling legislation to 30 June 2017.

While this is a step in the right direction for privately funded infrastructure projects in Australia, much of the detail is still to come. We expect further consultation in relation to design features of this measure, including criteria for “designated infrastructure projects”, in the coming months.



Goods and Services Tax (GST)

GST reform measures deferred

The Government has announced that it will defer the start date for a number of components of the 2009-10 budget measure, which implements the recommendations of the Board of Taxation's review of the legal framework for the administration of the GST.

The following measures, that were to commence from 1 July 2011, will now take effect from the first quarterly tax period after Royal Assent (or where appropriate, a later quarterly tax period):

- Adoption of the income tax self assessment regime for indirect taxes and refreshing the period of review.
- Reform of the change of use adjustments.
- Allowing adjustments for pre-registration acquisitions.
- Clarifying the treatment of tax law partnerships.
- Simplifying the GST group membership rules, including grandfathering of current membership rules and allowing grouping of non-operating holding companies and trusts.
- Amending the indirect tax sharing agreement provisions.
- Introducing a reverse charge for supplies of going concerns and farmland.

Given the complexity of a number of these measures, deferral of the start dates to allow additional time for development of the measures in consultation with taxpayers is welcome. However, it is disappointing that the Government has not seen fit to commit to a new timeframe for their introduction.

The Government has also announced that it will not proceed at this stage with the option to treat certain business-to-business supplies as taxable. This measure was scheduled to take effect on 1 July 2010. The deferral is intended to enable more extensive consideration of the possible wider use of reverse charging or GST-free business-to-business transactions.

GST treatment of property in possession of a mortgagee

The Government has announced that it will amend the GST law, with effect from 1 July 2012, to clarify its operation and reduce compliance costs for the mortgage lending sector.

In particular, the measure will clarify that the provisions, which make a creditor liable for GST on supplies of a debtor's property (where the supply is in satisfaction of a debt owed to the creditor) will operate to the exclusion of the special rules concerning representatives of incapacitated entities in circumstances where a mortgagee in possession or control sells the property of a corporation. The effect of this proposed measure is that such mortgagees will be able to continue to report and account for their GST obligations under a single GST registration.

GST and certain supplies to health insurers

The Government will amend the GST law to ensure that certain supplies made to health insurers in the course of settling health insurance claims will be GST-free with effect from 1 July 2000. This follows the decision of the Full Federal Court in *Commissioner of Taxation v Secretary to the Department of Transport (Victoria)* [2010] FCAFC 84, and is intended to restore the status quo.



Personal tax

There were no fundamental tax changes and no further tax cuts.

Deductions against Government assistance payments to be disallowed

As speculated, the tax law will be amended to prevent deductions being claimed against all Government assistance payments, in response to the 2010 High Court decision in *Commissioner of Taxation v Anstis* [2010] HCA 40. These amendments will have effect from 1 July 2011. This measure is intended to provide certainty as to the scope of eligible deductions.

Commencing the measure from 1 July 2011 will allow individuals who receive Youth Allowance (Student) to claim a deduction for expenses incurred in gaining their payment for the 2010-11 income year. This is to ensure individuals who have maintained records of their expenditure, following the High Court decision, are not precluded from claiming a deduction.

For each of the 2006-07 to 2009-10 income years, the Commissioner of Taxation has determined that he will administer the law to allow eligible taxpayers to receive an automatic deduction of \$550 or make potentially higher claims if expenses can be substantiated.

Changes to the low income tax offset

From 1 July 2011, the low income tax offset that is delivered to low and middle income earners through their regular pay during the year will increase from 50 per cent to 70 per cent of their total entitlements. The remaining 30 per cent of their low income tax offset benefit will still be paid as a lump sum on assessment of their income tax returns.

An individual's total low income tax offset entitlement, for any one tax year, will remain unchanged.

This change means instead of being compensated after the individual lodges their tax return, lower income earners are taxed less during the year.

Changes to the low income tax offset for non-work income of minors

From 1 July 2011, minors will no longer be able to use the low income tax offset to reduce income tax payable on their non-work income, such as dividends, interest, rent or royalties and other income from property.

This measure is intended to discourage income splitting between adults and children.

Minors will continue to be able to use the low income tax offset to reduce income tax due on their work income. This means that children under 18 will face the same tax rates on their income from work as those over 18 years.

Unearned income of minors who are orphans or disabled, as well as compensation payments and inheritances received by minors, will not be affected by this measure.

This measure will have a wide impact across many family businesses and the small to medium enterprise sector.

Medicare levy low income thresholds increase

From the 2010-11 income year, the Medicare levy low-income threshold will increase to \$31,789 (from \$31,196) for couples, and to \$18,839 (from \$18,488) for singles. The additional amount of threshold for each dependent child or student will also be increased to \$2,919 (from \$2,865).

The Medicare levy low-income threshold for pensioners below Age Pension age will also be increased. From 1 July 2010, the threshold will rise to \$30,439 (from \$27,697). This increase will ensure that pensioners below Age Pension age do not pay the Medicare levy when they do not have an income tax liability.

Personal tax

Phase out of dependent spouse tax offset

To encourage younger dependent spouses without children to seek paid employment, the tax offset for dependent spouses will be phased out. From 1 July 2011 taxpayers with a dependent spouse born on or after 1 July 1971 (i.e. a dependent spouse less than 40 years old) will no longer be eligible for the dependent spouse tax offset.

Taxpayers whose dependent spouse is a carer, who is an invalid or permanently unable to work and taxpayers eligible for the zone, overseas forces or overseas civilian tax offsets will not be affected by this change.

Dependent spouses with children are not affected by this measure because they are eligible for Family Tax Benefit Part B rather than the dependent spouse tax offset.

Family tax benefit

Family Tax Benefit Part A payments for families with teenagers will be increased by up to \$4,208 per year to support families to keep their teenagers in school or vocational training.

Special Disability Trust (SDT) – reform of CGT main residence exemption

Since 2006, families have been able to establish an SDT to provide for the current and future care and accommodation needs of a family member with a severe disability (the “principal beneficiary”). SDTs attract social security means test concessions for the eligible contributors and the principal beneficiary.

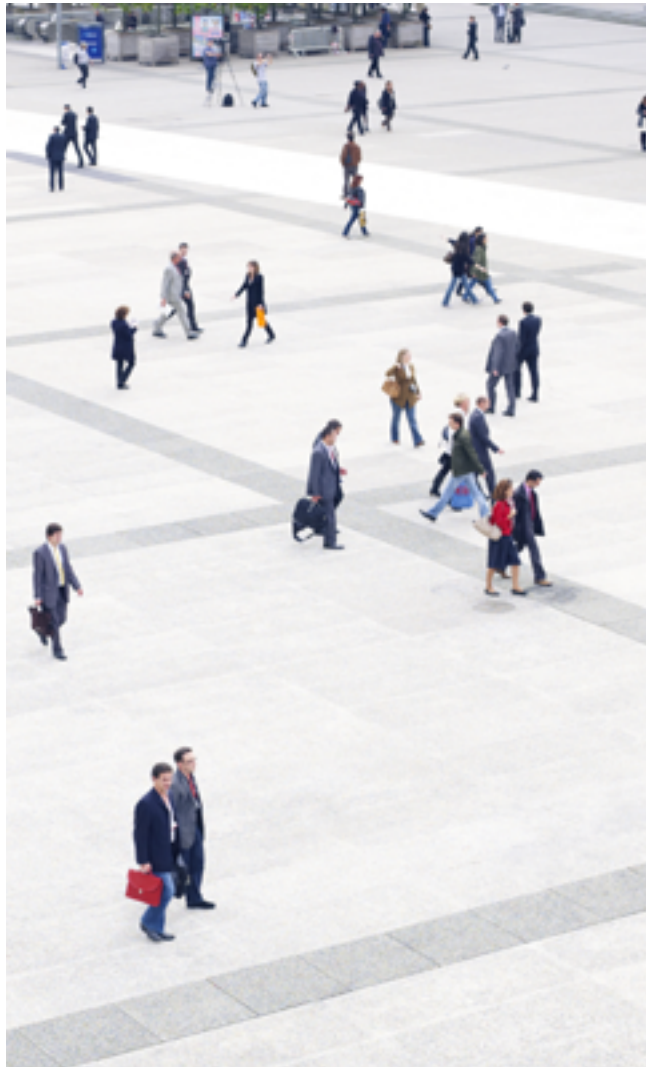
Until now however, a number of income tax barriers have discouraged the creation of SDTs. In a welcome move, the Government has announced that it will retrospectively change the tax law to:

- provide a capital gains tax (CGT) exemption for assets transferred into an SDT for no consideration
- backdate the application of the 2009-10 budget measure that provides a CGT main residence exemption for SDTs to 2006-07
- provide a CGT exemption for the recipient of the principal beneficiary’s main residence, if disposed of within two years of the principal beneficiary’s death, and
- ensure equivalent taxation treatment amongst SDTs established under the Veterans’ Entitlements Act 1986 (current rules limit the definition of SDTs in the tax law to SDTs established under the Social Security Act 1991).

These changes will apply from the 2006-07 income year, to align with when SDTs were first able to be established. The changes will initially be released in exposure draft form for community consultation.



Personal tax



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Personal income tax rates

There has been no change to the individual income tax rates*. The current legislated tax rates, applicable for the 2011-12 income year, are set out in the table below.

Tax threshold Income range (\$)	2011-12 (%)
0 - 6,000	0
6,001 - 37,000	15
37,001 - 80,000	30
80,001 - 180,000	37
180,000+	45

* Rates shown relate to resident adult individual taxpayers. Excludes Medicare levy, Flood and Cyclone Reconstruction levy and any tax offset entitlements

Personal income tax comparison chart*

Taxable Income (\$)	2011-12 (\$)
50,000	8,550
75,000	16,050
100,000	24,950
150,000	43,450
200,000	63,550
300,000	108,550
400,000	153,550
500,000	198,550

* Amounts shown relate to resident adult individual taxpayers. Excludes Medicare levy, Flood and Cyclone Reconstruction levy and any tax offset entitlements.

Flood and cyclone reconstruction levy

A Flood and Cyclone Reconstruction levy has been introduced to raise funds to assist those affected by the recent natural disasters. The levy of 0.5 per cent will be applied on taxable income between \$50,001 and \$100,000 and a levy of one per cent will be applied on taxable income above \$100,000. Individuals earning under \$50,000 of taxable income or those affected by the specified natural disasters will not be liable to pay the levy. This levy will only apply to the 2011-12 tax year.

Minimal impact for individuals

There were again minimal changes in the personal tax context. The paucity of personal tax changes may well reflect the fact personal tax bands are sufficiently well spread to ensure most Australians do not suffer an excessive tax burden. The targeting of the dependent spouse tax offset for phasing out in respect of spouses born on or after 1 July 1971 may seem insignificant but by the same token is consistent with the thinking behind the abolition of the entrepreneurs' tax offset in favour of the more widely targeted small business tax break.

Superannuation contributions continue to be capped at \$25,000 per year, albeit the Government is continuing its consultation process over the extension of the \$50,000 cap for persons aged 50 years and over beyond 2011-12 (and subject to superannuation balances below \$500,000). The "penalty tax regime" on excess contributions is proposed to be relaxed from 1 July 2011 on a once only basis for excess concessional contributions up to \$10,000. While this proposal is welcomed, it does not really address the issue of inadvertent breaches of the cap and is not retrospective.

Superannuation

There were no changes to the contribution caps or to the taxing of contributions or benefits. There are two reforms set out below. The latter one provides some relaxation of the “penalty regime” applying to those individuals whose contributions exceed the concessional (employer or deductible self-employed persons) cap of \$25,000 (or \$50,000 for persons aged 50 and over). The disappointing aspect is that both lack any retrospectivity and do not address the problem of an inadvertent breach of the cap.

Stronger Super – Self Managed Super Fund Reforms

To boost Government and public confidence in the self managed superannuation fund sector, a range of measures will be introduced to improve the operation, efficiency and integrity of the largest sector in the superannuation system. The measures include a new administrative penalty framework, registration of fund auditors subject to competency and independence standards, improved data collection and improvements to the self managed superannuation fund registration process.

From 2010-11 to 2014-15, the Australian Taxation Office (ATO) will be provided with \$40.2 million and Australia Securities and Investments Commission with \$8.4 million, for implementation of the measures. This will be funded by a \$30 increase to the self managed superannuation fund levy, from \$150 to \$180, with effect from 2010-11, and by collection of fund auditor registration fees.

Reform of Excess Contribution regime

From 1 July 2011, individuals who breach concessional contribution caps by up to \$10,000 can request the excess amount be refunded on a once only basis. Personal tax rates will apply in lieu of the potentially higher excess contributions tax rate, particularly where the excess contribution which is deemed to also be a non-concessional contribution causes a breach of the non-concessional cap.

The Government will consult with the superannuation industry on the implementation of this measure, and that will be an opportunity for sensible refinement of a regime which is seen by many as being unfair. The lack of retrospectivity must be a concern for both industry and the ATO.

The golden rule continues to be “make sure you understand your contribution caps and track your superannuation regularly”. That will not always be easy and you will need to work with your employer as the timing of contributions is critical, particularly around year end.



Small Business Tax Breaks

The Government has announced a number of tax concessions for all small business taxpayers which, according to Government, make up 96 per cent of Australian businesses. The concessions announced by Government in the budget or in its lead up are as follows:

Deduction for motor vehicles purchased in 2012-13

Prior to the budget, it was announced on 8 May 2011 that small business will be entitled to claim an immediate \$5,000 write-off of the cost of any motor vehicle purchased by small business operators from the 2012-13 year. The remainder of the purchase value can be transferred into the general small business depreciation pool, which is depreciated at 15 per cent in the first year and 30 per cent in later years.

Entrepreneurs' Tax Offset

Coinciding with this instant write-off for the first \$5,000 of any motor vehicle, the Government announced the removal of the Entrepreneurs' Tax Offset (ETO) with effect from the 2012-13 income year. The Australia's Future Tax System Review (AFTS Review) recommended that the ETO be abolished because of its poor targeting and high compliance costs.

Enhanced write-offs depreciating assets

From the 2012-13 year, small business will be entitled to claim an immediate write-off of all assets valued at under \$5,000 (increase from \$1,000 currently) and a write-off of all other assets (except buildings) in a single depreciation pool at a rate of 30 per cent. Currently, small businesses allocate assets to two different depreciation pools, with two different rates (30 per cent and five per cent) applying.

Both of these measures were previously announced following the recommendations by the AFTS Review.

Lower PAYG instalments

Pay As You Go (PAYG) instalments for small business in the 2011-12 year will be set at four per cent above the small business' taxable income for the previous year, which is half the statutory rate that would otherwise apply under the GDP adjustment factor method. The concession will have no relevance to taxpayers calculating instalments using the instalment income method. This concession will cease to apply for the 2012-13 year.

Small business concessions

The Government also proposes amending the definition of 'small business' to ensure that the provisions, which limit access to a range of tax concessions, are fully effective in that a trust will not be able to avoid being treated as a 'connected entity' on the basis that trusts do not own assets for their own benefit. The measures will ensure that some small businesses can access the small business capital gains tax (CGT) concessions because the changes will make their business assets active. These small business proposals will apply for CGT events occurring after 7.30pm (AEST) on 10 May 2011.

Reduction in tax rate

As previously announced, from the 2012-13 year, small businesses that are incorporated will receive a reduction in the company tax rate to 29 per cent.

Fringe Benefits Tax (FBT) changes

As speculated, the Government announced changes to the “statutory formula” method for calculating Fringe Benefits Tax (FBT) on car fringe benefits. The changes will replace the current four-tiered statutory rate system with a flat statutory rate of 20 per cent that will apply regardless of the kilometres travelled.

The new rate applies to new vehicle contracts entered into after 7.30pm (AEST) on 10 May 2011, and but will be phased in over four years in the manner set out in the table below.

There are two methods available to employers to determine the value of a car fringe benefit - the “statutory formula” method and the “operating costs” method. The statutory formula method is often preferred from a compliance perspective, as the “operating costs” method requires employees to maintain a log book record of business travel to determine the business percentage applicable to the car. Under the “statutory formula” method, a statutory fraction is applied to the base value of the car to determine its taxable value. The statutory fraction is based on the total kilometres travelled in the year under the current four-tiered system.

While the budget announcement will significantly reduce the tax concessions available for those who drive more than 25,000km a year, the alternative “operating costs” method will still be available for those who use their car for a substantial amount of work-related travel. This will ensure that business use of a vehicle will be excluded from FBT.

Changes to car fringe benefit rules

Distance travelled during the FBT year (1 April – 31 March)	Statutory rate (multiplied by the cost of the car to determine a person’s car fringe benefit)				
	Existing contracts	New contracts entered into after 7:30pm (AEST) on 10 May 2011			
		From 10 May 2011	From 1 April 2012	From 1 April 2013	From 1 April 2014
0 – 15,000 km	0.26	0.20	0.20	0.20	0.20
15,000 – 25,000 km	0.20	0.20	0.20	0.20	0.20
25,000 – 40,000 km	0.11	0.14	0.17	0.20	0.20
More than 40,000 km	0.07	0.10	0.13	0.17	0.20



Fringe Benefits Tax (FBT) changes

What does this mean for employers?

- The current seven per cent statutory fraction for cars that travel over 40,000km per year approximates an 80 per cent business use percentage if an employer was to use the alternative operating cost method. Where cars are used for a substantial amount of work-related travel, employers should consider using logbooks in accordance with Australian Taxation Office guidelines so not to incur a significant increase in the FBT liability associated with car fringe benefits.
- Employers should revisit car policies, and implement a communication strategy for employees about the changes.
- The phasing-in arrangements – particularly the 10 May 2011 start date impacting the current 2011-12 FBT year – mean that an employer's FBT calculations and record-keeping will be more complex throughout the transitional period. Work should start on adjusting in-house FBT software. Commercial FBT software suppliers will no doubt move quickly to issue updated versions of their existing software.
- Employers who outsource their employee benefit arrangements should make contact with their provider and ensure they are prepared for the changes.

What does this mean for employees?

- Car salary packaging arrangements will need to be revisited to understand the implications on the employee's total remuneration. Post-tax contribution strategies, where applicable, will need to be updated.
- Car salary packaging arrangements will need to be revisited to understand the implication for an employee's reportable fringe benefits amount. This amount affects various surcharges (for example, the Medicare levy surcharge), liabilities (child maintenance) and entitlement to Government benefits.
- Interestingly, the budget change is described by the Government as both a taxation and environmental reform. As shown in the above table, if an employee currently travels between 15,000 and 25,000 kilometres per year, the changes will make no difference to the taxable value of the car fringe benefit. If an employee travels over 25,000 kilometres per year, the tax benefit will decrease, but there will still be a tax benefit, so the employee is likely to continue to salary package and drive the car. If an employee travels less than 15,000 kilometres per year, it is less likely that they would have salary packaged a car as any tax benefit is inconsequential. However, by introducing a 20 per cent statutory rate on low kilometre users (for example for commuters who travel to and from work but not much additional travel), an employee may now be encouraged to start packaging a car. In terms of road congestion, these changes may very well increase peak hour travellers, but discourage drivers taking those long country drives on the weekend (allegedly in the last weeks of March each year).



Tax Administration

Improving tax fairness and compliance

The Government proposes a package of three measures to improve tax compliance across various aspects of the economy. The Government's intention is to create a more level playing field for taxpayers in line with the Government's stated commitment of ensuring that all taxpayers pay their fair share of tax.

The package of reforms announced in this year's Federal Budget is comprised of the following measures:

Reporting taxable payments

This measure has two components aimed at improving compliance with taxation obligations by contractors.

Firstly the Government will introduce a requirement for certain businesses in the building and construction industry to report to the Australian Taxation Office (ATO) annually, on payments made to contractors in the industry, along with the contractor's Australian Business Number (ABN), with effect from 1 July 2012. This regime will allow data-matching to provide information for review, targeted audits or further assistance and education.

Secondly, the Government will undertake public consultation during 2011-12 to examine a reporting regime for payments made to contractors in the commercial cleaning industry. The ATO will be funded to implement the reporting regime and to assist with educating the industry about the new regime and their tax obligations.

These measures are a continuation of the Government's policy of increasing compliance arrangements in industries where the use of contractors is prevalent.

Enhanced fraud detection and management in relation to tax refunds

Under this measure, the ATO will focus on preventing instances of over-claiming before tax refunds are issued. The additional funding provided by Government will also allow the ATO to conduct additional business education and/or enforcement activities and develop further intelligence and analytic detection models.

It remains to be seen what effect this measure will have on the processing of legitimate large refund claims.

Reporting of Government grants and payments

Under this measure the ATO will monitor and collect payment information from Government agencies in relation to grants across all three levels of Government, and will develop more sophisticated data-matching capacity to examine compliance by the recipients of Government grants and payments.



Other Key Tax Measures

International measures

Interim Investment Manager Regime

The Government will extend its previously announced interim Investment Manager Regime (IMR) arrangements to address uncertainty regarding the taxation arrangements for certain portfolio investment income of foreign managed funds.

From 2009, the United States FIN 48 (now ASC 740-10) accounting standard required funds to make financial account disclosures on uncertain tax positions, including for prior income years. This affected foreign funds investing in Australian equities and other securities, which could yield profits regarded as Australian sourced income. As a result, many foreign funds simply stopped investing in Australia and some invested indirectly using synthetics.

Under this measure, the Government will amend the law so that where a “foreign managed fund” has never lodged an Australian tax return and has not been notified of an audit or review by the Australian Taxation Office (ATO), the ATO will generally not raise an assessment in respect of certain portfolio investment income of the fund for the 2010-11 or prior income years. This measure, which was initially announced on 17 December 2010 to apply for the 2009-10 and prior income years, has now been extended to the 2010-11 income year.

The concept of a “foreign managed fund” will be subject to further consultation but is stated to have the following broad features:

- Not an Australian tax resident.
- Widely held (and not closely held).
- Undertakes passive investment.
- Does not carry on or control a trading business in Australia.

The proposal covers income and realised gains and losses arising from the following investments by foreign managed funds including:

- portfolio interests in companies (including companies listed on the ASX), portfolio interests in other entities (including units in a unit trust) and bonds, except to the extent the amount gives rise to a withholding tax liability, and
- financial arrangements (for example, derivatives) and foreign exchange transactions, except to the extent they are in respect of an underlying interest that is otherwise taxable (such as “taxable Australian property”).

The Government’s actions seek to improve investor certainty in relation to the treatment of past transactions of foreign managed funds. This means that exposure to tax on certain gains or profits realised until 30 June 2011 (the 2010-11 income year) are closed off. However, for unrealised gains or profits on investments held as at 30 June 2011 that are realised after this date, or profits realised on investments acquired after 30 June 2011, we await the outcome of the Board of Taxation’s review of the IMR as it relates to foreign managed funds. The Board is due to report to Government by 30 September 2011.

MIT withholding tax

The Government indicated that it will update the list of countries reported in the *Taxation Administration Regulations 1976* whose residents are eligible to access the reduced 7.5 per cent rate of withholding tax on certain distributions from Australian managed investment trusts (MITs). The list will be updated to include Belize, the Cayman Islands, the Commonwealth of the Bahamas, the Principality of Monaco, the Republic of San Marino, the Republic of Singapore, St Christopher and Nevis and St Vincent and the Grenadines.



Other Key Tax Measures

Taxation of Financial Arrangements (TOFA)

The 2011-12 Federal Budget included a number of proposed changes to certain TOFA rules that had not previously been announced:

Debt and equity rules – integrity measure clarified

An integrity rule in the debt and equity provisions in the income tax law that commenced to apply with effect from 1 July 2001 will be clarified.

The existing provisions include an integrity rule (section 974-80) which, if triggered, results in an interest held by an entity in a “connected entity” being treated as an “equity interest”, despite the fact that apart from the integrity rule, the interest would be classified as debt.

This integrity rule has been of concern for many corporate taxpayers (and entities taxed as companies). It is welcome news that the Government has proposed that the rule be retrospectively amended (with effect from 1 July 2001) to ensure that the provision will only apply to arrangements where both the purpose and effect of the arrangement is that the “ultimate investor” has, in substance, an equity interest in the issuer company.

Additionally, the rule is to be amended to give the Commissioner of Taxation discretion to not apply the rule where the Commissioner considers that it would be unreasonable for the integrity rule to apply.

Functional currency rules

The operation of the functional currency rules will be extended to allow certain trusts and partnerships that keep their accounts solely or predominantly in a particular foreign currency to calculate their net income by reference to that currency. The measure will take effect from the date of enactment of the amending legislation.

Hedging rules

The TOFA hedging rules will be amended to:

- ensure that for taxpayers that have elected to apply both the tax hedging rules and the reliance on financial reports method, only the effective portion of the gains and losses from hedging financial arrangements will be subject to the tax hedging rules, and
- clarify that gains and losses from hedging financial arrangements that hedge a risk(s) in relation to a firm commitment (as defined in the accounting standards) are brought to account for tax purposes when gains, losses or other amounts in relation to the assets or liabilities arising out of the cessation of the firm commitment are recognised for tax purposes.

These changes, which will ensure that the rules can operate as intended, will apply from the start of the income year that the TOFA hedging rules first apply to the taxpayer.

Deducting company losses

The Government proposes to amend the company loss recoupment rules from the 2011-12 income year to make it easier for companies to satisfy the continuity of ownership test (COT) in certain circumstances. Under the proposal, the law is to be amended so that in applying the COT, a company will not be required to trace ownership of its shares through certain superannuation entities.

The amendments will also remove technical deficiencies in the modified COT rules for “widely held entities” where:

- an entity is interposed between certain stakeholders and the loss company in certain circumstances
- an interposed entity demerges
- an interposed foreign entity issues bearer depository receipts, or
- a corporate change arising from the issue of new shares happens.

The amendments will also ensure that all “membership interests” held in an entity are treated as a single asset for the purpose of applying the low value asset (less than \$10,000) exclusion under the loss integrity rules (i.e. for unrealised loss rules and inter-entity loss duplication rules).

Other Key Tax Measures

Capital gains tax reforms

There are a number of capital gains tax (CGT) amendments proposed by Government including:

Changes to scrip for scrip rollover relief

For CGT events occurring after 7.30pm (AEST) on 10 May 2011, the Government has announced that it will ensure that the CGT scrip for scrip rollover integrity provisions that apply to individuals and companies will also apply to interests held by trusts, superannuation funds and life insurance companies.

These integrity provisions apply to transactions where stakeholders in the target and acquiring entities have the potential to influence both entities. Since some trusts, superannuation funds and life insurance companies have considered that these provisions do not apply to them because, as the stakeholders, they own the interests for the benefit of others, rather than for their own benefit. The Government proposal is to amend the law so that this unintended interpretation of the provisions will no longer be available, and that the provisions will unarguably apply to all stakeholders.

CGT exemption for incentives related to renewable resources or for preserving environmental benefits

Under this measure (to apply to income tax assessments for the 2007-08 income year and later income years) the Government will exempt from CGT, any gains or losses arising from a right to a financial incentive granted to taxpayers under a Commonwealth, State or Territory Government scheme that encourages them to acquire renewable resource

assets (for instance, photovoltaic solar cells or solar hot water systems) or for their agreeing to preserve a part of Australia's environmental amenity (for instance, for refraining from removing remnant vegetation). This measure will also 'turn off' the income tax recoupment rules in relation to any underlying assets (for instance, a solar hot water system).

Limiting the trading stock exception for superannuation funds

With effect from 7.30 pm (AEST) 10 May 2011, the Government will amend the income tax law to remove the trading stock exception to the CGT 'primary code rule' applicable to complying superannuation entities for specified assets. The measure will ensure gains or losses on specified assets (including shares, units in a trust and land) held by complying superannuation entities are subject to CGT. According to Government a small number of complying superannuation entities are seeking to treat shares as trading stock, so as to deduct losses on their shares against income other than capital gains. Transitional rules will apply to ensure that assets held or accounted for as trading stock before the time of announcement are unaffected.

Minor amendments

The Government will make minor amendments to ensure the proper functioning of the CGT and associated provisions which include the below:

- Ensuring that the rollover for the exchange of shares in one company for shares in another company operates properly, so that there is deferral of a profit or loss where the original shares are held on revenue account at the time of the exchange. This change will have effect from 7.30 pm (AEST) on 10 May 2011.
- Amending the rollover applicable to certain disposals of assets by a trust to allow rollover relief to apply where a transferee company or trust holds rights, just before the disposal or transfer time, associated with a deed or similar document that is designed to facilitate the transfer of assets into the company or trust. These changes to the rollover for the disposal of assets by a trust to a company will have effect for CGT events happening after 7.30 pm (AEST) on 10 May 2011 and the changes to the rollover for the transfer of assets between certain trusts will have effect for CGT events happening on or after 1 November 2008.
- Ensuring that gains and losses arising from life insurance policies that are generally exempt from CGT are not taxed under the ordinary income tax provisions by removing the exception to the CGT 'primary code rule' for such gains and losses. This will remove uncertainty in the application of income tax to compensation or damages payments made under life insurance policies. These changes will apply to CGT events happening in the 2005-06 income year and later income years.
- Legislating the current ATO practice of allowing a testamentary trust to distribute an asset of a deceased person without a CGT taxing point occurring. The income tax law in relation to deceased estates will also be rewritten using a principle based format including minor technical corrections. These changes will apply to CGT events happening on or after the day the legislation is enacted.

Other Key Tax Measures

CGT and other rollovers for amalgamations of indigenous corporations

The income tax laws will be amended to ensure that there are no immediate taxation consequences for *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (CATSI Act) corporations that amalgamate with one or more other CATSI Act corporations, with effect for the 2007-08 and later income years. The measure will provide a CGT rollover for members' interests in CATSI Act corporations that amalgamate, and will also provide a rollover for any gains or losses realised by the original corporation when it ceases to own its CGT assets, revenue assets, trading stock and depreciating assets that become assets of the newly amalgamated entity.

Petroleum Resource Rent Tax — clarifying the taxing point

The Government will amend the law to provide greater certainty around how the 'taxing point' is calculated for the purposes of the Petroleum Resource Rent Tax (PRRT), with effect from 1 July 1990.

The location of the taxing point within a PRRT project is used in determining PRRT liabilities, and was the central issue recently considered by the Federal Court in *Esso Australia Resources Pty Ltd v Commissioner of Taxation* [2011] FCA 360.

The amendments will provide further statutory support for the Court's judgment, will be consistent with the established application of the PRRT law, and will provide greater certainty for PRRT taxpayers.

Not-for-profit sector reforms

Better targeting of not-for-profit tax concessions

The tax concessions provided to not-for-profit entities will be reformed to ensure they are targeted only at those activities that directly further a not-for-profit entity's altruistic purposes.

The new arrangements will commence on 1 July 2011 and will initially affect only new unrelated commercial activities that commence after 7.30 pm (AEST) on 10 May 2011.

Under this measure, the not-for-profit income tax concessions will only apply to profits generated by unrelated commercial activities that are directed back to a not-for-profit entity to carry out its altruistic work. This means not-for-profit entities will pay income tax on profits from their unrelated commercial activities that are not directed back to their altruistic purpose.

Not-for-profit entities, in respect of their unrelated commercial activities, will also not have access to the fringe benefits tax exemptions or rebate, goods and services tax concessions, or deductible gift recipient support in relation to those activities.

Commercial activities that further a not-for-profit entity's altruistic purposes, and small-scale and low-risk unrelated commercial activities, will not be affected by the reforms.

Not-for-profit entities with existing unrelated commercial activities will initially be able to continue to use their tax concessions to support these activities. Transitional arrangements will be introduced for these existing activities, with the intention of phasing these out over time.

Not-for-profit entities that have entered into a government service delivery contract as at 7.30 pm (AEST) on 10 May 2011 will be allowed to use their tax concessions in support of that contract.

Introduction of a statutory definition of 'charity'

Following a consultation process, a statutory definition of 'charity' will be introduced for all Commonwealth laws, to take effect from 1 July 2013. The Government will also consult with the States and Territories with the intention of developing a consistent definition of 'charity' that can be adopted by all jurisdictions.

The Australian Charities and Not-for-profits Commission will commence operations from 1 July 2012. It is intended that the Commission will develop new guidance for the sector, implement system changes, and re-assess the charitable status of entities on the basis of the new statutory definition.

Tax Legislative Pipeline

While we welcome the Government's continued commitment to better tax design and implementation (as evidenced by the Board of Taxation's "Post-implementation review of the tax design review panel recommendations", which commenced in February 2011), the

Government has a large number of key announcements made prior to this year's budget that have yet to be legislated.

Some of the more significant, yet to be legislated announcements from the current Government are below.

Measure	Status
<i>Introduction and implementation of the proposed Minerals Resource Rent Tax (MRRT) and extension of the Petroleum Resource Rent Tax (PRRT).</i>	Consultation on policy design was undertaken by the Policy Transition Group (PTG) in 2010. The Government announced on 24 March 2011 that it has accepted all 98 recommendations of the PTG (see PwC's Special Publication, March 2011). Although no exposure draft legislation has been released to date, consultation with the industry and the tax profession is currently being undertaken by the Resource Tax Implementation Group.
<i>Reduction in the company tax rate to 29 per cent.</i>	Proposed to apply to small business taxpayers from 1 July 2012, and all other corporate taxpayers from 1 July 2013.
<i>General trust tax reform, including rewrite of existing provisions.</i>	Exposure draft legislation in relation to certain improvements to the taxation of trust income was released for public comment on 13 April 2011. These proposed changes (primarily in relation to the streaming of trust income) are expected to apply from 1 July 2010. Consultation arrangements and timing in relation to the broader review of trust taxation are yet to be determined.
<i>Managed Investment Trust regime.</i>	Following the submissions received on the consultation on policy design that concluded late last year, the Government announced on 8 April 2011 that the start date would be delayed until 1 July 2012 to give industry additional time to prepare for the practical consequences of the reforms. Consultation on draft law is expected to commence in the coming months.

Tax Legislative Pipeline

Measure	Status
<i>Review of the foreign source income anti-tax-deferral (attribution) rules (i.e. the controlled foreign company (CFC), proposed foreign accumulation fund (FAF) regime and related rules).</i>	Treasury has received submissions on its Exposure draft legislation released for public comment in February 2011. No further timeframes or commencement dates have been released.
<i>Further refinements to the taxation of financial arrangements (TOFA) rules, including foreign currency amendments.</i>	<p>In relation to the refinements to the TOFA rules, further consultation is expected. Note that further refinements were also advised in this year's Federal Budget.</p> <p>Legislation is expected to be introduced into Parliament in the 2011 Winter Sittings (which commenced Tuesday 10 May 2011) to give effect to the proposals relating to the foreign currency provisions, which have been outstanding for some years.</p>
<i>Off-market share buy-backs to implement the recommendations of the Board of Taxation's review of the tax treatment of off-market share buybacks.</i>	These measures were proposed to take effect for off-market share buy-backs undertaken after the date of Royal Assent of amending legislation. Although consultation on policy design concluded in July 2009, no Exposure draft law has been publicly released.
<i>Changes to the company loss recoupment rules to recognise multiple classes of shares.</i>	We finally expect to see the legislation introduced into Parliament in the 2011 Winter Sittings (which commenced Tuesday 10 May 2011). Although note that further refinements to the company loss recoupment rules were advised in this year's Federal Budget.
<i>Further Goods and Services Tax (GST) administration reforms arising from the Board of Taxation review into the legal framework for the administration of the GST.</i>	Exposure draft legislation covering some measures has already been released for public comment. However, there remain a number of complex reforms where the details are yet to be determined.

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