

# FEDERAL BUDGET 9 MAY 2006

The Treasurer, The Hon Peter Costello, delivered his 11th Budget last night. On the tax front, there has again been an array of measures announced.

These range from personal income tax cuts, measures to appeal to businesses both large and small, such as improvements to tax depreciation arrangements and small business concessions, as well as measures to further reduce tax red tape in a number of areas. On top of this, there are major changes planned in the area of superannuation.

This Special Budget Edition of our Newsletter summarises the tax related changes.

## 1. Personal tax measures

The 2006-07 Budget provides cuts to personal income tax worth \$36.7 billion (including the reduction in the fringe benefits tax rate noted below) over the next four years. This comes on top of the \$21.7 billion of tax cuts provided in the 2005-06 Budget.

### 1.1 Personal income tax cuts

From 1 July 2006:

- the 30% threshold will increase to \$25,001;
- the 42% marginal tax rate will be cut to 40% and the threshold will increase to \$75,001;
- the top marginal tax rate will be cut from 47% to 45% and the threshold will increase to \$150,001.

As a result, the new tax thresholds for Australian residents will be as follows:

Current Thresholds		New Thresholds	
\$	%	\$	%
0 - 6,000	0	0-\$6,000	0
6,001-21,600	15	6,001-25,000	15
21,601-63,000	30	25,001-75,000	30
63,001-95,000	42	75,001-150,000	40
95,001 +	47	150,001 +	45

As a result of the reduction in the top marginal tax rate, various consequential changes will be made to different parts of the tax law that use the top marginal tax rate. For example, the top marginal tax rate is applied to contributions and earnings of non-complying superannuation funds, the unearned income of minors and the net income of a trust estate to which no beneficiary is presently entitled.

### 1.2 Low income tax offset increased

From 1 July 2006, the low income tax offset will increase from \$235 to \$600 and will begin to phase-out from \$25,000. Taxpayers eligible for the full offset should not pay tax until their annual income exceeds \$10,000 (up from \$7,567).

The Medicare levy low income phase-in rate will be reduced from 20% to 10%.

### 1.3 Senior Australians' Tax Offset increased

From 1 July 2006, senior Australians who receive the Senior Australians' Tax Offset will be able to earn more income without paying tax. Singles will be able to have taxable income up to \$24,867 (up from \$21,968) and couples up to \$41,360 (up from \$36,494).

The Medicare levy thresholds that apply to senior Australians will also be increased to ensure that they do not pay the Medicare levy until they begin to incur an income tax liability.

### 1.4 Increase in Medicare levy thresholds

From the 2005-06 income year, the Medicare levy low-income threshold will increase to \$16,284 for individuals and \$27,478 for families. The additional amount of threshold for each dependent child or student will also be increased to \$2,523. The increase in thresholds takes into account movements in the CPI.

The Medicare levy threshold for pensioners below age pension age will also be increased. From 1 July 2006, the threshold will rise to \$19,583. This will ensure that pensioners below age pension age do not pay the Medicare levy while they do not have an income tax liability.

### 1.5 Part-year tax free threshold for students removed

The Government will remove the part-year tax-free threshold for taxpayers ceasing full-time education, with effect from the 2006-07 income year.

Extending the full tax-free threshold to all resident taxpayers that cease full-time education for the first time is expected to reduce compliance costs by removing the requirement to calculate a part-year tax-free threshold and end the requirement for taxpayers to isolate income and deductions attributable to the period during which a taxpayer was engaged in full-time study.

## 2. Business measures

### 2.1 Small business CGT concessions

Following recommendations by the Board of Taxation arising from its post-implementation review of the small business CGT concessions, the Government has announced that it will amend the small business CGT concessions to make them simpler, clearer and fairer and to reduce compliance costs for small business. Access to the concessions will also be improved.

The Board of Taxation's report made 39 recommendations - 26 legislative and 13 administrative. The Government accepted all but one of the legislative recommendations (3 with minor amendments favouring taxpayers) and the Australian Taxation Office accepted all administrative recommendations.



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The amendments to the concessions will include:

- changes to the maximum net asset value test, the active asset test, the 15-year exemption, the retirement exemption, the small business roll-over and the application of the concessions to partnerships.
- the current controlling individual 50% test will be replaced with a new significant individual 20% test that can be satisfied either directly or indirectly through one or more interposed entities. This will allow up to eight taxpayers to benefit from all of the concessions instead of the current limit of two controlling individuals.

The proposed changes will apply to CGT events that happen in the 2006-07 and later income years.

The Government also announced that it will be increasing the net assets threshold from \$5 million to \$6 million and allowing STS taxpayers to be eligible for the concessions without having to satisfy the net assets threshold.

## 2.2 Fringe Benefits Tax changes

The Government indicated that it would be implementing a number of measures in relation to fringe benefits tax ("FBT"). These measures include:

- a reduction in the FBT rate from 48.5% to 46.5%, with effect from 1 April 2006;
- increasing the in-house fringe benefits tax-free threshold from \$500 to \$1000 with effect from 1 April 2007. This will reduce compliance and record keeping costs for an employer who provides goods or services to its employees that are identical or similar to goods or services supplied to the public in the ordinary course of the employer's business;
- extending, with effect from 1 April 2007, the FBT concessions for remote areas by broadening the definition of remote where the shortest practicable route involves travel over water. This measure recognises that it is generally more difficult and inconvenient to travel over water than to travel over land and the required distance between a location and the nearest population centre will be halved where the shortest practicable route involves travel over water. Where the shortest practicable route involves travel over both land and water, the broadened definition will allow for apportionment.

## 2.3 Family trusts

As part of its initiative to simplify and streamline the tax system, the Government will also make changes to the family trust election rules to increase flexibility for family trusts. The changes can be summarised as follows:

- it will be possible to revoke or vary family trust elections and interposed entity elections in certain limited circumstances;

- the definition of a family group will be broadened to include lineal descendants of family group members; and
- trust distributions to former spouses, and to widows or widowers of family group members with new spouses will be exempted from family trust distribution tax.

## 2.4 Improving depreciation arrangements - diminishing value rate to 200%

In a welcome move for business, the Treasurer announced that the Government is raising the diminishing value rate under the uniform capital allowance ("UCA") regime in Division 40 of the Income Tax Assessment Act 1997 from 150 per cent to 200 per cent for all eligible assets. The Treasurer explained that this is equivalent to a 33% increase in the allowable depreciation rate for these assets.

The measure will apply to assets used for a taxable purpose acquired on or after 10 May 2006 and will include assets that taxpayers start to hold (for example, through leasing arrangements) for the purposes of the UCA regime. The legislation to give effect to the announcement, together with "appropriate integrity measures" will be introduced at the "earliest opportunity".

## 2.5 Changes to GST

The Government announced that it will increase the cash accounting turnover threshold from \$1 million to \$2 million for the goods and services tax ("GST") concessions for small businesses and align certain GST definitions of turnover with the simplified tax system definition. The Government will also discuss the simplified GST accounting method with the Commissioner of Taxation and suggest that the threshold be aligned with the other thresholds at \$2 million.

## 3. International tax measures

### 3.1 Distributions to non-resident trustee beneficiaries

Currently a resident trustee is liable to pay tax on distributions to non-resident individuals and companies. The non-resident is also assessed on the distribution with a credit for tax already paid by the resident trustee.

As an integrity measure and to reduce compliance costs, from 1 July 2006 the Government will require that resident trustees also pay tax on distributions to non-resident trustee beneficiaries. This measure will ensure that trust distributions to non-resident trustees are taxed in the same way as distributions to other non-resident beneficiaries.

## 4. Superannuation

### 4.1 Simplifying and streamlining superannuation

The Government has released a plan to simplify and streamline superannuation that is intended to remove the current tax complexities faced by retirees, improve retirement incomes, give greater flexibility over how superannuation savings can be drawn down, and improve incentives to work and save.

Should the plan be implemented, improved retirement incomes are anticipated and over 10 million Australians with superannuation accounts would benefit through greater simplicity.

Some of the key aspects of the changes identified in the plan are as follows:

- Australians aged 60 and over who have already paid tax on their superannuation contributions and earnings would not pay tax on their superannuation benefits from 1 July 2007;
- reasonable benefit limits will be abolished;
- age-based deduction limits would also be removed. Instead, deductible contributions up to a limit of \$50,000 per person per annum would be taxed at a concessional rate of 15% (there will be a transitional period for people aged 50 and above). Undeducted contributions would be limited to \$150,000 in a year;
- the ability to make deductible superannuation contributions would be extended to age 75;
- deductibility of contributions by self-employed taxpayers will be treated the same way as contributions made by employers for the benefit of employees;
- the pension assets test will be reformed to reduce the assets test taper rate from \$3.00 to \$1.50 per fortnight with effect from 20 September 2007. A pensioner's home would remain outside the assets test.

### 5.1 Philanthropy and deductible gift recipient arrangements

The government is to introduce measures to enhance philanthropy and streamline compliance arrangements for deductible gift recipients ("DGRs").

The first measure will provide "more options for philanthropy by allowing taxpayers to claim a tax deduction for the donation of publicly listed shares acquired more than 12 months ago and valued at \$5,000 or less to a deductible gift recipient". However, it is noted that taxpayers will still be subject to capital gains tax.

Under the second measure, the Commissioner of Taxation's power to review DGRs listed in the tax law (to ensure their activities align with the purposes and activities that they were listed to undertake) is to be extended. The final measure aims to lower the compliance costs for certain DGRs by removing the requirement to maintain separate gift funds for each DGR endorsement or listing and allowing entities to maintain one gift fund for all DGR supported activities and purposes.

### 5.2 Tax deductions for boat hire arrangements

The Government will allow taxpayers who cannot demonstrate that they are actually carrying on a business using a boat to claim deductions for costs associated with hiring out their boats. Currently, where carrying on a business cannot be demonstrated, all receipts from the activity must be returned as income but no expenses can be offset against that income.

The measure will allow taxpayers who cannot demonstrate that they are carrying on a business using their boat to deduct expenditure relating to their boating activity up to the level of income generated from their boating activity. Any excess deductions can be carried forward and deducted against income from that boating activity in future years.

## 6 Other Matters not in Budget

### 6.1 GST and deposits for goods purchased or hired

The Tax Office has issued a ruling on deposits that demonstrates just how complicated a supposedly simple law can get.

Unfortunately, the problem it highlights is that, sometimes, deposits that are too high are not 'deposits' for GST purposes. If it's not a deposit, the business may have to pay GST to the Tax Office on the full purchase price of the goods sold in their next BAS. That can create real problems.

#### Deposits and the GST Act

If a business receives a deposit, as such, there is normally no GST payable until the sale goes through or the deposit is forfeited.

However, if the amount paid is not a 'deposit':

- for suppliers that account on a non-cash basis, the whole of the GST is attributable to the tax period in which the 'deposit' is received; and
- for suppliers that account on a cash basis, GST is attributable on the amount of the 'deposit' received in the tax period.

#### A deposit must be reasonable

For a deposit to be what is called a "security deposit" for the purposes of the GST Act, the amount of the deposit must be reasonable.

It is the Commissioner's view that for a deposit that exceeds 10% in a purchase contract to be accepted as a security deposit, suppliers must be able to show that they are at a higher risk of significant losses in the event of default.

#### Example: Payment not a deposit as the amount is unreasonable

Mary wants to purchase a new mattress from Furniture Pty Ltd and chooses one that is priced at \$660.

The salesperson advises her that she must provide a deposit

of \$220 before her order will be taken. It is made clear that if she cancels the order prior to delivery, she will forfeit the entire \$220.

The payment is one third of the purchase price, which is considered unreasonably high in the circumstances given that it is a standard stock item. The ATO does not consider it to be a deposit.

If the supplier accounts on a non-cash basis, the GST payable of \$60 is attributable to the tax period in which the amount is received. If the supplier accounts on a cash basis, the GST payable of \$20 is attributable to the tax period in which the amount is received.

## 6 Management fees to service entity deductible

In a recent case, the Administrative Appeals Tribunal held that a taxpayer could claim a deduction for the payment of management fees of \$1.165 million to a related company, even though:

- the payment reduced the taxpayer's taxable income in that year to nil;
- a written agreement about the arrangement was not executed until the following income year; and
- the majority of the fees were also paid in the following income year.

The directors of the taxpayer company were concerned about protecting the company's assets, as well as legitimately limiting tax.

As a result, they decided to establish another company that would provide management services to the taxpayer for a sizeable fee.

The taxpayer claimed a deduction in the 1996 income year for a fee of \$1.165 million due to the service company, even though it only paid approximately \$50,000 of that in that income year, and a written service agreement was not executed until November 1996.

Nonetheless, the Tribunal was satisfied that:

- the taxpayer entered into an oral agreement prior to the end of June 1996 committing it to pay the fee to the related entity;
- the fee payable was calculated at the end of June 1996, and that the taxpayer became obliged in June 1996 to pay the full amount, even though the whole amount was not paid over immediately; and
- a desire to protect assets was the taxpayer's principal motivation in agreeing to the establishment of the service company arrangement. Therefore, the management fees of \$1.165 million were deductible in the 1996 income year

## 7 FBT:

### 7.1 Per km rates for vehicles other than cars

The following are the rates to be applied where the cents per kilometre basis is used to calculate the taxable value of a fringe benefit arising from the private use of a motor vehicle other than a car for the FBT year commencing 1 April 2006:

Engine Capacity	Rate per km
0-2500cc	40 cents
Over 2500cc	48 cents
Motor cycles	12 cents

This method can only be used where there is extensive business use of the vehicle.

### 7.2 Benchmark interest rate

The benchmark interest rate for the FBT year commencing 1 April 2006 is 7.30% p.a – replacing the rate of 7.05% that applied in 2005/06.

### 7.3 Record keeping exemption

The small business record keeping exemption threshold for the FBT year commencing 1 April 2006 is \$6,391, replacing the amount of \$6,223 that applied in the previous FBT year.

## 8 Reducing Government Red-tape

The Government has announced a number of actions to reduce the regulatory burdens on business (in response to recommendations regarding these burdens), which include:

- an increase in the minor fringe benefits exemption threshold from \$100 to \$300, effective from 1 April 2007; and
- an increase in the fringe benefits reporting exclusion threshold from \$1,000 to \$2,000, effective from 1 April 2007.

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