

NEWSLETTER – BUDGET 8 MAY 2012

COMMENTARY

The Treasurer announced his “on time, as promised” budget surplus with a headline surplus for 2012/13 of \$1.5 billion. Mr Swan also indicated that there would be an increasing budget surplus over the next four years. It is interesting to note that the budget deficit forecast at \$37.1 billion for 2011/12 had blown out to \$44.4 billion.

1- PERSONAL INCOME TAX

Changes to income tax rates

No further changes were announced to income tax rates for resident taxpayers in the 2012/13 Budget. However, the Government have announced a number of changes for tax rates relating to non-residents (refer below).

Medical expenses tax offset to be means tested

From 1 July 2012, the net medical expenses tax offset ('NMETO') will be means tested. For people with adjusted taxable income above the Medicare levy surcharge thresholds (\$84,000 for singles and \$168,000 for couples), the threshold for claiming the NMETO will increase to \$5,000 (indexed annually). Further, the rate of reimbursement will reduce to 10% of eligible out of pocket medical expenses above the threshold from the current 20%. People with income below the thresholds will be unaffected. The threshold is currently \$2,060 for the 2011/12 financial year (indexed annually), with a rate of reimbursement of 20%.

Consolidation of the dependency offsets into one

With effect from 1 July 2012, eight dependent tax offsets will be consolidated into a single non-refundable offset. The new consolidated offset will be available to taxpayers who maintain a dependent that is genuinely unable to work due to carer obligation or disability. The new offset will be based on the highest rate of the existing offsets that it replaces and will result in an increased entitlement for many taxpayers. It will still be possible to claim the offset in respect of multiple dependents provided all dependents meet the criteria.

The offsets being consolidated are the invalid spouse, carer spouse, housekeeper (with or without child), child-housekeeper (with or without child), invalid relative, and parent/parent-in-law tax offset.

Phase out of mature age worker tax offset

From 1 July 2012 the mature age worker tax offset will be phased out for taxpayers born on or after 1 July 1957. The Government will instead provide a Jobs Bonus of \$1,000 to \$10,000 directly to employers who recruit and retain workers aged 50 years or over for more than three months.

This change will not affect any person who currently receives the tax offset, as access will be maintained for taxpayers who are aged 55 years or over in the 2011/2012 financial year.

Increase to Medicare levy low income thresholds

With effect from 1 July 2011, there will be increases to the income thresholds at which Medicare becomes payable as follows:

	2011	2012
Individual	\$18,839	\$19,404
Single Pensioner below Age Pension Age	\$30,439	\$30,451
Family	\$31,789	\$32,743
*additional amount of threshold for each dependent child or student	\$ 2,919	\$ 3,007

Schoolkids Bonus

The Government confirmed that it was replacing the previous Education Tax Refund with the new Schoolkids Bonus. From 1 January 2012, eligible families with children in school will receive \$410 for each child in primary school and \$820 for each child in high school.

To be eligible, families must qualify for the Family Tax Benefit Part A. There will no longer be any requirement to keep receipts to substantiate eligible expenditure.

Entitlements to the Education Tax Refund for the 2011/12 year will be paid out in full in June 2012 so those eligible will not be required to keep receipts and claim the refund in their 2011/12 tax returns.

Changes to Family Tax Benefit Part A

Four changes to the Family Tax Benefit Part A were announced in the Budget.

From 1 January 2012 the eligibility will be limited to young people under 18 years old or where they are still in secondary school, the end of the calendar year in which they turn 19.

The maximum payment rate for families with one child will be increased by \$300 and for 2 or more children by \$600 p.a..

Base rate increases will be \$100 and \$200 p.a. respectively. These rate increases will be effective 1 July 2013. Where people receiving Family Tax Benefit Part A travel overseas for more than 6 weeks, the rate of payment will be reduced to the base rate effective from 1 January 2013.

People with an income range between \$6,000 and \$18,200 will be able to update their incomes online, over the phone or in person with the Department of Human Services (rather than by lodgement of their tax return) so that their entitlement can be reconciled or determined.

Previously announced measures that have been dropped

The first measure relates to the standard tax deduction that was to be provided to individuals for work related expenses and the costs of managing their tax affairs. The second measure is in relation to the 50% tax discount for interest income.



2 - SUPERANNUATION CHANGES

Contributions tax will increase for individuals on incomes above \$300,000, the concessional contribution cap for 2012/13 will be \$25,000 and there was no change to existing pension tax arrangements.

Increase in contributions tax for people on incomes over \$300,000

From 1 July 2012 contributions tax will increase from 15% to 30% if your 'income' is more than \$300,000. Income is likely to include taxable income, concessional superannuation contributions (superannuation guarantee and salary sacrifice contributions), adjusted fringe benefits, total net investment loss, tax-free Government pensions and benefits, certain foreign income, less child support.

If an individual's income excluding their concessional contributions is less than \$300,000 but the inclusion of their concessional contributions pushes their income over \$300,000 the higher tax rate will apply to the part of their contributions above \$300,000.

The higher contributions tax rate will not apply to excess concessional contributions as these contributions are already taxed at an effective rate of 46.5%.

Super contributions within allowable limits still provide tax advantages and should be considered as a part of your overall retirement planning.

The Government have stated the tax exemption on pension fund earnings will remain unchanged.

Deferral of higher concessional contributions cap for individuals over 50

The Government has confirmed that from 1 July 2012 the standard concessional contribution limit of \$25,000 will apply universally. The higher concessional contribution limit of \$50,000 announced in the last two Budgets for individuals over age 50 with superannuation balances under \$500,000 has been deferred until 1 July 2014.

Contribution arrangements may need to be reviewed given the concessional contribution cap may be lower than anticipated.

Taxing of employment termination payments

At present, employment termination payments ('ETPs') are taxed at a maximum rate of 15% for those over preservation age (currently 55 years of age) and to a maximum rate of 30% for those under preservation age, up to an indexed cap, which is \$165,000 in 2011/12.

From 1 July 2012, the Government will limit the concessional taxation treatment of certain affected ETPs, such as golden handshakes, so that only that amount which takes a person's total annual taxable income (including the ETP) to no more than \$180,000 will receive the ETP tax offset. Any amounts of an ETP which takes the employee's total income above the

\$180,000 cap will be taxed at the employee's marginal tax rate, typically 46.5%.

The \$180,000 total income cap will also complement the existing ETP cap (increasing to \$175,000 in 2012/13) which ensures the ETP concessions can only apply up to the ETP cap in any event.

These measures will not affect current arrangements for certain ETPs relating to genuine redundancy, invalidity, compensation for an employment related dispute and death.

Self-managed fund auditors

The Government reiterated the creation of an auditor registration process for self-managed funds to be administered by ASIC and enforced by the ATO.

The process will now require a self-managed fund auditor to sit a compulsory competency exam. This measure highlights the increasing focus on self-managed fund compliance and a likely increase in audit activity in the sector.

The measure will be funded in part by an increase in the self-managed fund levy (currently \$180). The specific increase has not been announced.

Superannuation data standards

A new levy on superannuation fund members (other than members of self-managed funds) totalling \$467 million over seven years was announced for the implementation of new superannuation data standards. The new data standards aim to improve transaction efficiencies in areas such as employer contributions, account consolidation, member transfers and benefit payments.

If implemented, the way employers administer their superannuation is likely to change significantly.

3 - CORPORATE

Previously announced measures that have been dropped

The Government will not be proceeding with the following previously announced measures.

Reduction in corporate tax rate

The proposed reduction in the company tax rate to 29% from the 2013/14 income year (2012/13 for small companies) will not be proceeding.

Green Buildings program

Tax Breaks for Green Buildings program. They were going to allow, businesses that undertook capital works to improve their energy efficiency would have been able to apply for a one-off bonus tax deduction.

Loss carry back regime

From the 2012-13 income year, companies (but not trusts or other entities) will be allowed to carry-back tax losses so they receive a refund against tax previously paid. A one year loss carry-back will apply in 2012-13, where tax losses incurred in

that year can be carried back and offset against tax paid in 2011-12. For 2013-14 and later years, tax losses can be carried back and offset against tax paid for up to two years earlier.

Companies will be able to carry back up to \$1 million of revenue losses each year. This will provide a maximum cash benefit of up to \$300,000 a year. However, loss carry back will be limited by reference to a company's franking account balance, therefore payment of franked dividends in a prior year may reduce a company's ability to carry back losses.

Revenue losses not carried back will still be available to be carried forward and utilised subject to the current loss recoupment rules.

Limited recourse debt amendments

Existing provisions can apply to disallow capital allowance deductions (including depreciation deductions) for expenditure on assets financed by limited recourse debt. In many cases, the limited recourse debt provisions can reverse such amounts and require an amount to be included in assessable income.

The ATO recently lost a High Court case on the basis that the current definition of limited recourse debt does not extend to debt that is only effectively limited recourse, for example where the borrowing entity has no other assets and is 100% debt funded. This case restricted the breadth of the limited recourse provisions.

The definition of limited recourse debt will be amended to include debts which are effectively limited recourse with effect from 8 May 2012. The extended definition will likely broaden the application of the limited recourse debt provisions in transactions involving a refinancing or where debts are forgiven.

Bad debts and related party financing

A deduction is generally allowable for writing off a debt which arose either from a transaction that gave rise to assessable income such as a sale of goods or services, or from a loan made in the course of a money lending business.

The Government has announced in the Budget that it will introduce measures to deny a tax deduction where a bad debt is written off between related parties outside of tax consolidation.

4 - CAPITAL GAINS TAX

Extensions to revenue assets and trading stock roll-overs

Scrip for scrip roll-over is to be broadened to ensure that taxation on the exchange of shares in a company or units in a unit trust is deferred where the shares or units are held as trading stock or as revenue assets. The roll-overs will be made available provided the general conditions of each of the roll-overs are met. Prior to these changes, roll-overs for interests held as trading stock or revenue assets were only available in respect of shares in consolidated groups.

The measure will require the replacement shares in the interposed company to maintain the character of the original revenue asset or trading stock asset that was exchanged. The changes will apply from 7:30pm on 8 May 2012.

These amendments ensure that taxpayers will not inadvertently miss out on the rollover provisions simply because their shares are not held as a CGT asset.

Integrity changes for scrip for scrip rollover

The Government has announced a number of changes to the integrity provisions in respect of the scrip-for-scrip rollover measures.

Integrity provisions currently apply in respect of the scrip for scrip roll-over measures for shareholders with sufficient interests to potentially influence both the target and acquiring entity in a restructure. Where the integrity provisions apply, the cost base in the target entity that is acquired is inherited from the original shareholder.

In response to the loss in the case of *FCT v AXA Asia Pacific Holdings Ltd*, the Government will specifically introduce measures that will ensure that the integrity rules apply when the original interests are rights to acquire ownership interests, such as convertible preference shares. The Government has also announced that it will tighten the existing integrity measures that apply to intragroup debt and equity interests issued as a part of a scrip-for-scrip arrangement.

Broadening exemptions for compensation payments and insurance policies

The Government announced minor extensions to CGT exemptions for compensation payments and insurance policies with effect from 1 July 2005.

Under the current rules, there is uncertainty as to whether the existing CGT exemptions for compensation payments in respect of personal injury would flow through to beneficiaries of a trust where such payments are made to the trust on behalf of the beneficiary.

There is also uncertainty as to whether the existing CGT exemptions for life insurance policies and annuity instruments would flow through to beneficiaries of a trust where the trust is the original owner of the policy or instrument.

The new measures ensure that a taxpayer who receives any compensation, damages or certain insurance proceeds indirectly through a trust will have the same CGT outcomes as a taxpayer who receives such amounts directly.

Clients may therefore wish to review the status of their life insurance policies and annuity instruments as the new measures should remove any detrimental CGT outcomes from holding such policies within a trust structure.

Amendment to beneficial interests

Minor changes are proposed to measures announced in last year's Budget, which sought to change the way in which the scrip for scrip roll-over measures and small business concessions apply to trusts, superannuation funds and life insurance companies. Taxpayers can choose to apply the changes from the 2008-09 year, otherwise the changes will automatically apply from the date of Royal Assent of the new legislation.

5 - INTERNATIONAL TAX

Tax rate increase for non-resident individuals

Personal income tax rates for non-resident individuals will be adjusted, commencing from 1 July 2012. The adjustment will effectively seek to align the tax rates of non-residents with residents within certain thresholds, by merging two thresholds and increasing the rate of tax to 32.5%. The following table outlines the current non-resident tax rates.

Taxable income (\$)	Tax Payable (\$)
0 – 37,000	29%
37,001 – 80,000	10,730+33% of excess over 37k
80,001 – 180,000	23,630+37% of excess over 80k
180,001+	60,630+45% of excess over 180k

Taking into account the announced changes, the non-resident tax rates that will apply for the 2012-13 income year are as follows.

Taxable income (\$)	Tax Payable (\$)
0 – 80,000	32.5%
80,001 – 180,000	26,000+37% of excess over 80k
180,001+	63,000+45% of excess over 180k

The Government has also proposed that the 32.5% tax rate will be increased to 33% from 1 July 2013. The following table outlines the tax rates proposed for the 2013-14 income year.

Taxable income (\$)	Tax Payable (\$)
0 – 80,000	33%
80,001 – 180,000	26,400+37% of excess over 80k
180,001+	63,400+45% of excess over 180k

Removal of 50% CGT discount for non-resident individuals and trusts

Non-resident individuals and trusts will no longer enjoy the 50% discount on capital gains accrued after 7.30 pm (AEST) on 8 May 2012.

Non-residents are only subject to income tax on capital gains derived on the disposal of "taxable Australian property", which includes Australian real property, assets of a business carried on through a permanent establishment in Australia, and mining assets (or an option or right to acquire these assets) whether these are held directly or indirectly through a company or trust. Prior to the announcement, non-resident individuals and trusts were eligible for the 50% CGT discount on these gains where these assets were held for greater than 12 months.

The CGT discount will remain available to non-resident individuals and trusts for capital gains accrued prior to Budget night, where the non-resident chooses to obtain a market valuation of the relevant asset as at this date.

Non-residents currently holding taxable Australian property with unrealised capital gains will therefore need to consider obtaining and incurring the cost of a market valuation in order to protect their access to the discount on any future disposal.

Managed Investment Trust increase in withholding tax

The rate of withholding tax on certain payments by Australian managed funds to residents of information exchange countries is to rise from 7.5% to 15% (see Trusts and Funds).

6 - TRUSTS AND FUNDS

Reform of the taxation of trusts

On 21 November 2011 the Government released a consultation paper ('the Paper') as the next stage in its plans to rewrite the taxation of trust provisions.

Whilst the Government specifically ruled out taxing trusts as companies in the Paper, all other trust related issues were on the table for discussion. However, the Government also stated that the more issues that were raised for consideration the longer would be the likely legislative timeline. The Government had proposed to release its further consultation paper as part of this Budget.

The Government has stated that it "will consider options which ensure that businesses and individuals can continue using trusts, with confidence that the tax outcomes applying to their circumstances are fair and consistent."

7 - FRINGE BENEFITS

Reforms to living away from home allowances & benefits

Contrary to the proposals announced in November 2011, measures to reform the tax treatment of living away from home allowances and benefits will now apply equally to all employees, whether temporary or permanent tax residents in Australia. A twelve month limit on accessing the concessions is also a new feature not contemplated in the original reform proposals.

Key features of the reforms, set to take effect from 1 July 2012 are as follows.

- Tax concessions for employees living away from home will only be available to employees who maintain a home for their own use in Australia and then live away from it.
- The concessions will apply for a maximum period of 12 months for an individual employee at any work location.

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- The reforms will apply from 1 July 2012 for arrangements entered into after 7.30pm on 8 May 2012, the current concessions will continue to apply up to 30 June 2014 for arrangements entered into prior to that time.

Whilst the reforms will impact on employees temporarily living away from home, they will not affect other concessions such as flyin fly-out arrangements, or the tax treatment of travel and meal allowances for employees who travel away from their home overnight. In our view, the tightening of the concessions will adversely impact on costs to businesses as they are likely to have to pay more to employees to attract them to temporary assignments, particularly highly skilled employees from overseas who are often recruited to Australia to overcome skill shortages.

The notion that living away from home concessions have been exploited and misused by a narrow group of people, particularly highly-paid executives, ignores the fact that many not so highly remunerated employees are asked to live away from home on temporary assignments. In those cases, the concessions have represented reasonable compensation for the disadvantages that result. We believe that these measures go too far in placing a twelve month limit on access to the concessions, as many legitimate temporary assignments run for much longer. If a limit were to be imposed which reflects the duration of most temporary assignments, it should be in the order of two to four years.

The introduction of transitional provisions to preserve current concessions up to 30 June 2014 is for arrangements entered before 7.30pm on 8 May 2012.

Airline transport fringe benefits

The Government has announced changes to modernise the valuation methodology applicable to airline transport fringe benefits.

Airline transport fringe benefits arise where employees of airlines or travel agents are provided with free or discounted air travel subject to the stand-by restrictions customarily applied to employees in the airline industry.

Previously, the taxable value was calculated with reference to the stand-by value, less any employee contribution. The taxable value will now be ascertained using the market value. These changes will apply to benefits provided after 7.30 pm on 8 May 2012 and will effect employers for the first time in the 2012 / 2013 FBT year.

We expect that employers will face increased compliance costs determining market values to ascertain their correct FBT liability under this measure. That is, but for any compliance saving measures that may be contained in the new measures, employers will be required to establish an appropriate "market value" of the benefits provided.

8 - GOODS AND SERVICES TAX & OTHER TAXES

More GST compliance funding for the ATO

In the 2010-11 Budget the Government allocated \$337 million to the ATO over a period of 4 years to fund GST compliance activities, including targeting fraudulent GST refunds, underreporting of GST liabilities, failure to lodge GST returns and outstanding GST debts.

The Government has now announced that a further \$195 million will be provided to the ATO for its GST compliance activities and that the targeted GST compliance program will be extended for a further 2 years out to 2015-16.

The increase in compliance funding is expected to generate an additional \$3.6 billion of GST revenue during the period up until 2015-16. This will go some way towards offsetting the downward revision of estimated GST receipts due to the softening economy and slow-down in consumer spending. The ATO has significantly increased its targeted GST compliance activities in recent years. The additional funding announced in this year's Budget is likely to result in an increasing number of GST registered businesses being targeted for ATO reviews and audits.

We recommend that all GST registered entities ensure that their GST affairs are in order before they are examined by the ATO.

GST-free health supplies

A Bill is currently before Parliament to ensure that medical treatment is GST-free where it is provided to a patient but the supply is technically made to (and payment is received from) an insurer, a compulsory third party scheme operator or a Government agency.

The GST-free treatment will now be extended to circumstances where the supply is made to (and payment is received from) a statutory compensation scheme operator.

Road User Charge and fuel tax credits

From 1 July 2012, the Road User Charge which applies to registered vehicles with a gross vehicle mass of more than 4.5 tonnes operating on a public road for business purposes will increase from 23.1 to 25.5 cents per litre.

This increase in the Road User Charge will reduce the fuel tax credits available to operators of these vehicles from the current 15.043 cents per litre to 12.643 cents per litre, thereby adding to the cost pressures on heavy transport operators who are also being impacted by the rising cost of fuel at the pump.

9 - ADMINISTRATION

The Government has announced a number of measures to broaden the Commissioner's powers in administering the tax system, including the ATO's ability to enforce outstanding debts and withhold refunds, and the scope of the general anti-avoidance rules.

Tax collection and refunds

The Government announced that it will provide \$106 million over four years to the ATO to improve the management of outstanding taxation debts and superannuation guarantee charges. This will allow the ATO to provide more targeted assistance to taxpayers in meeting their reporting and payment obligations, but is also likely to result in increased scrutiny of amounts left outstanding with the ATO.

In addition to this, the Government has also announced significant increases in ATO funding relating to GST compliance (refer to Goods and Services Tax and other taxes).

General anti-avoidance provisions

As previously announced, the Government will broaden the scope of the general anti-avoidance rule ('Part IVA') for transaction entered into with effect from 2 March 2012. The amendments are aimed at countering arguments that some taxpayers have successfully used in the context of corporate restructures to show that they did not get a 'tax benefit' - which is a necessary prerequisite for the application of Part IVA. While details have not yet been released on this measure, the proposed broadening of Part IVA is likely to impact mostly on those taxpayers undertaking restructures or internal reorganisations.

10 – FINANCIAL YEAR END ITEMS

Medical health insurance rebate

The Government has previously announced that the medical insurance rebate (at present 30%) will be eliminated for those earning \$130,000pa or more or \$260,000pa as a family. There is a phasing in between \$84k and \$130k for singles and \$168k and \$260k for families. This means testing will apply from 1 July 2012.

However Medical Funds will accept annual payments in advance, so if clients who are affected, paid 1 year in advance before 30 June 2012 they will still receive the rebate and still be covered for the following year, even though they wouldn't be eligible for the rebate if they paid it after 1 July 2012.

CGT for non-residents of Australia

As mentioned previously, the 50% CGT concession will no longer be available for non-residents who sell Australia CGT assets after 8 May 2012. However, this means that non-residents should obtain a valuation for assets that will be subject to CGT as at 8 May 2012 as values up to that date will still receive that concession. Therefore those clients affected should obtain a valuation as at that date.

Trust resolutions

It has always been the law (even though it has been recognised in its breach rather than its adherence) that trusts must resolve before the end of the financial year, as to where and to whom its income is to be distributed. The ATO have made it known that they will be concentrating on this area of administration so we advise all clients to hold their trustee meetings regarding the distribution of 2012 income before the year ends. If help is needed in this area, please do not hesitate to contact our office for help.

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