

# A vision of the Economy in the Asian century?



## 2011 Federal Budget Overview



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## Patchy work leaves some businesses out in the cold

By Stephen Cribb, Director Business Services and Taxation

### Overview

Healthcare, particularly mental health, is a major focus of the 2011 Federal Budget. There are few sharp edges in this budget that does little to raise the heartbeat in new revenue measures. Headaches, however, are on the horizon with red tape on the increase for business, particularly in the management of motor vehicles as affected employees storm their HR departments seeking certainty under new rules. Small business is out in the cold (again). There is little to energise middle income families. New measures to get the unemployed into the workforce are the one welcome feature that may offer some hope to businesses competing in a tight job market.

Australia is often described as having a 'patchwork' economy, with the mining and resources industry riding the 'Mining Boom Mk 2' but many segments of the economy are struggling to gain momentum. Little is offered to those segments of the economy most affected by the strong Australian dollar. Manufacturing and tourism receive no special assistance to help them through tough times. There is little to excite exporters in incentives to develop export markets. There are no new incentives on research and development or innovation to stimulate emerging new businesses. No steps have been taken to protect business affected by the dumping of cheap product in Australian markets.

The big measures - adoption of remaining Henry Review recommendations, addressing distortions in the allocation of GST revenue between the States and promulgating a framework for the proposed carbon tax, are reserved for another day. The vision remains undelivered.

### Checklist

- Re-budget FBT costs of your motor vehicle fleet for new measures applying from 10 May
- Executives with car travel <15,000 km pa may benefit from packaging a car
- If car travel is >25,000km per year, evaluate the need to now keep a log book or remove future cars from packaging in the next four years
- Consider timing of vehicle acquisitions in 2012/13 to benefit from accelerated deductions for the purchase of a new car
- Don't distribute more than \$416 to the kids in 2011/12 (down from \$3,333) from family trusts
- Pay your HECS liability upfront prior to 1 January 2012 to preserve the 20% discount
- Charities should ensure they qualify for the new definition applying to Not for Profits (NFPs)
- If you are affected by excess super contributions < \$10,000, relief is available from 1 July 2011
- Small business should review sale/succession strategies, using the concessional CGT rules to ensure integrity rules do not remove their access to concessions
- People engaged in share trading in their superfund should assess the impact of not being able to revalue trading stock balances at 30 June 2011 and beyond.

## Car Fringe Benefits - low kilometre cars save the planet!

Packaged cars are assessed to FBT using either the concessional 'statutory method' or the more onerous operating cost method (which involves keeping of a log book).

The current 'statutory rates' used to value a motor vehicle fringe benefit, become more favourable the more kilometres a car travels. This triggers the absurd behaviour of driving the car further to get into a lower tax rate. Trips to Perth or Noosa are not unheard of!

Responding to a Henry Review recommendation, the current stepped rate will be phased out over the next four years and replaced with a flat statutory rate of 20%.

### Current FBT rules apply to existing cars at 10 May 2011

Currently held motor vehicles will continue to be valued for FBT purposes using the existing statutory rates.

### Phased rules apply to new cars over four years

The 20% flat rate will only apply to motor vehicles purchased after 7.30pm (AEST) on 10 May 2011 and will be phased in over four years for cars that cover more than 25,000km.

- Private car users travelling less than 15,000km may find a benefit in packaging often for the first time
- Private car users travelling between 15,000 and 25,000km will experience no difference
- Private car users travelling more than 25,000km may need to reassess the effectiveness of salary packaging on new cars
- Business users will need to maintain a logbook to cut the FBT cost where the car travels more than 25,000km on new cars.

The 20% statutory rate used to apply to motor vehicles where the annual travel was between 15,000 and 25,000 kilometres. When the new rules are fully phased in from 1 April 2014, the 20% rate will apply to all motor vehicles, regardless of how many kilometres they travel.

#### Illustration of packaging under the new system

Depending on the use of the motor vehicle, the rules for new cars may increase or decrease the FBT payable.

For a \$40,000 motor vehicle, the FBT payable will be \$7,921, irrespective of kilometre travel (assuming a 47.5% top marginal tax rate including 2012 flood levy).

Under the old statutory rate rules the FBT payable may have been as low as \$2,772 (40,000km) or as high as \$10,297 (<15,000km).

Importantly, cars travelling <15,000km will deliver an FBT saving of \$2,376 over the present arrangement creating an opportunity for employees to package cars in low kilometre cases.

Fleet managers will be delighted that an entire new potential market has opened up. However for businesses with high business and kilometre travel, red tape on cars will increase with a need for a logbook.

## Other business measures

### Accelerated depreciation of motor vehicles

This is not really a 2012 measure. The Government asserts that investment in motor vehicles forms one of the most significant investment requirements of many small businesses. As a result, from the 2012/13 financial year the Government will allow small businesses to claim an immediate deduction of \$5,000 for vehicles purchased. The balance of the vehicle's acquisition price will be pooled as part of the general small business pool and depreciated at 15% in the first year and 30% in the remaining years.

#### Illustration of the new regime

Consider a \$20,000 motor vehicle purchased by a business in the 2012/13 year. The 2012/13 deductions will include the upfront deduction of \$5,000 and a depreciation of deduction of \$2,250 (\$15,000 x 15%). This equates to total deductions of \$7,250.

We note the Henry recommendation was to extend this measure to all assets, not just motor vehicles. It is difficult to understand the rationale for such selectivity, which defeats the simplification benefits of one common approach.

In connection with the above changes, the Government is removing the entrepreneur's tax offset provisions. This removal will take effect from the 2012/13 financial year.

### Infrastructure investment concessions improve access to loss recoupment provisions

There is one thing infrastructure projects tend to do early in their lifecycle - make losses. Investors may also come and go with the changing fortunes of the project. Losses in this early cycle can be hard for investors to access due to 'continuity of ownership' and 'same business' tests. For companies, the Government will be amending these rules on losses carried forward to make the tests easier to pass for investors. This increased certainty of preserving tax benefits is expected to increase investment. Superannuation investment is specifically targeted with new rules to ensure that ownership does not need to be traced through certain superannuation entities.

### Capital Gains Tax amendments

The Government will make various amendments to the Capital Gains Tax (CGT) provisions. Most of these changes affect business taxpayers and can be summarised as follows:

- With respect to the CGT small business concessions, changes proposed by the Government will ensure that trusts cannot argue they are not 'connected' with business assets on the basis that trusts do not own assets for their own benefit. These changes will also allow some businesses to now access the small business concessions. It will place other business people beyond the maximum asset value required to qualify for the CGT concessions.
- The scrip for scrip rollover integrity provisions will be amended to ensure they apply to trusts, superannuation funds and life insurance companies, in the same way they apply to individuals and companies.
- The Government will exempt from CGT, gains or losses arising from a right to a financial incentive granted under a Government scheme. This is a technical amendment that applies from the 2007/08 financial years and is designed to ensure the correct operation of the Government's environmental schemes.

- The 2009/10 budget measures to provide a CGT main residence exemption to Special Disability Trusts will be extended.
- There are various other minor technical corrections to ensure the correct operation of the CGT regime.

### GST changes

The most significant change to be implemented by the Government with respect to GST relates to the treatment of new residential properties. Pursuant to the case of *Commissioner of Taxation v Gloom Investments (Trustee)* [2010] FCAFC 46, the Federal court determined that the sale of certain newly constructed properties to owner occupiers and investors were not subject to GST.

Leading on from this case, the GST provisions are to be amended to ensure that the supply of new residential premises is appropriately subject to GST.

Other amendments to be made to the GST provisions include the following:

- Changes will be implemented to ensure that mortgagees in possession of property (or control) of a corporation will continue to report and account for the GST obligations of the property under a single registration.
- The Government has revised the start date for a number of GST changes proposed in the 2009/10 budget. The revised start date will be the date of royal assent.
- Certain supplies to health insurers in the course of settling an insurance claim will be GST free.
- The annual GST instalment system will be extended to small business in a refund position.

### Other FBT changes

Other FBT changes to be implemented by the Government relate to the FBT exemption provided for domestic fly-in fly-out arrangement. This exemption will be extended to cover Australian residents working overseas in remote areas.

## Individuals and families

### Removing minors' eligibility for the low income tax offset on unearned income

From 1 July 2011, minors (<age18) will no longer be eligible to use the low income tax offset against unearned income. Unearned income includes trust distributions, dividends, interest, rent, royalties and other income from property.

For the 2011 income tax year minors will still be able to receive \$3,333 in unearned income and pay no tax. For the 2012 and later income tax years they will only be able to receive \$416 in unearned income (which is the tax free threshold for minors).

### Other measures

- The dependent spouse rebate for spouses under 40 with no children is to be phased out to encourage non-working spouses into employment.
- Currently 50% of the low income tax offset is factored into the withholding rates applicable for low income employees. This will be increased to 70% with the balance refunded when the taxpayers tax return is lodged.
- From 1 July 2011 self education expenses will no longer be deductible against any Government assistance payments.

- From 1 January 2012 the discount available to students for paying their HECS up-front will be reduce from 20% to 10%. The bonus on voluntary payments to the ATO of more than \$500 will also reduce from 10% to 5%.
- From 1 July 2011 families in receipt of Family Tax Benefit Part A will be able to take up to 7.5% of their entitlement in a lump sum (up to a maximum of \$1,000).
- Indexation of Family Tax Benefit Part A and B supplements will be suspended for three years. Family payment higher income thresholds and limits will also be frozen until 1 July 2014.
- From 1 January 2012 the eligibility for Family Tax Benefit Part A will be limited to children up to the age of 21.
- GDP adjustment factor for PAYG Instalment taxpayers is to be reduced from 8% to 4% for the 2011/2012 income tax year. This will reduce PAYG Instalments payable during the year hence providing cash flow relief to taxpayers.

## Superannuation changes

### Refund of excess concessional contributions

Taxpayers will be able to have excess concessional contributions (compulsory superannuation guarantee payments, salary sacrifice contributions and other deductible contributions) taken out of their superannuation fund and taxed at their marginal tax rate. The measure will only apply for the 2011/2012 or later years and where the breach is for less than \$10,000 and it is the first time the taxpayer has made a breach.

This is a win for taxpayers and common sense. Often the breach is outside the taxpayers control (ie the taxpayer can not control when their employer makes compulsory superannuation contributions) and often the breach is only minor. Under existing law excess concessional contributions are taxed at 46.50%. Under the proposed changes the tax rate is reduced to the taxpayers marginal tax rate.

### Other measures

- Trading stock rules will not apply to complying superannuation funds. This will ensure the Superannuation funds that make losses from share trading will not be able to deduct those losses against non capital gains income. This change will apply from budget night.
- An extension of time until 30 September 2011 has been given to merging superannuation funds during which time they can still avail themselves of CGT loss rollover relief. This is important as many funds have realised and unrealised capital losses which would be forfeited without this extension.
- The reduction in the minimum pension drawdown factor will be phased out in the 2011/2012 income tax year. The minimum drawdown factor was halved in the 2009, 2010 and 2011 income tax years. In the 2012 income tax year, the reduction will only be 25% and this will reduce to Nil in the 2013 income tax year.
- Persons over the age of 50 will still be able to contribute \$50,000 in concessional contributions, where their total superannuation account balances are less than \$500,000. It was due to drop to \$25,000 from 1 July 2012.
- Freeze on superannuation co-contribution indexation extended until 2012/2013 income tax year.

## Corporates and financial arrangements

The Government has announced a number of changes with respect to the taxation of financial arrangements of Australia's corporate taxpayers. These changes include changes to Debt v Equity provisions, TOFA provisions and securities lending arrangements.

With respect to the Debt v Equity Regime the integrity provision is to be amended to restrict its application. These provisions deem interest from an arrangement that funds a return through connected entities to be an equity interest in certain situations. These provisions will be amended to ensure they only apply where the ultimate investor has, in substance, an equity investment. The debt v equity provisions will also be amended to provide further discretionary powers to the Commissioner with respect to these integrity provisions.

The Government will also be making changes to ensure the hedging provisions contained within TOFA regime function correctly. The TOFA provisions implemented for stages 3 and 4 will also be amended to give the Commissioner power to allow taxpayers additional time to lodge transitional elections.

The tax provisions dealing with the securities lending arrangements will also be updated. The provisions associated with who is the holder of securities will be updated.

## Not for Profit Organisations

### Better targeting of concessions

Tax concessions provided to NFP entities will be reviewed to ensure that they are targeted only at those activities that directly further the NFPs' altruistic purposes. The new measures will apply from 1 July 2011 and will initially only affect new unrelated commercial activities that commence after 10 May 2011. Tax will only be payable on profits from their unrelated commercial activities where they are not directed back to their altruistic purpose, ie the earnings they retain in their commercial undertaking.

FBT exemptions or rebates, GST concessions and deductible gift recipients support will also not be available in respect of unrelated commercial activities.

Existing unrelated commercial activities will still be subject to tax concessions subject to transitional rules yet to be determined by the Government.

### Other measures

The Government will consult on and introduce a statutory definition of 'charity' for all Commonwealth laws to take effect from 1 July 2013.

If you would like to discuss how these matters will affect your circumstances, please contact your Principal Adviser.



Disclaimer: The information contained within this document is intended to be general in nature and should not be interpreted as individual advice. Please contact Prosperity if you require specific information or advice.

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