2005-06 Federal Budget Report

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Grant Thornton

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Overview

Highlights

Amid the background of continued strong domestic demand and the shadows cast by the constraints of limited productive capacity, the 2005-06 Budget was delivered last night by Federal Treasurer, Mr Costello. An underlying cash surplus of $8.9 billion is predicted.

For more than a generation, Australians have grown used to moderate-to-high unemployment rates. Now, almost every industry is suffering from labour and skills shortages. Ironically, despite continued strong domestic demand, Australia's economic growth (ie real GDP) has slowed to 2% for 2004-05 and is only forecast to increase to a modest 3% for 2005-06. That labour force surveys only forecast employment growth of 1 ¾% for 2005-06 and 1 ½% for each of the two years following is an issue of concern for business, whose ability to grow is being squeezed by so-called "full employment".

In response to this problem, the Government is putting its' faith in the ingenuity of people and companies to pursue a number of benefits designed to boost workforce participation and business investment to drive capacity:

- Personal income tax cuts, especially for high income earners
- Increased vocational skills and training
- A Welfare to Work programme
- Tax incentives to attract expatriate workers
- Removing the 3% tariff on certain imported business inputs
- Broadening capital gains tax exemptions to foreign investors in certain Australian private companies
- Committing to review Australia's venture capital industry, including tax incentives
- Providing tax relief for "blackhole" expenditures

The unfortunate "blackhole" in the 2005-06 Budget is the lack of commitment to structural reform, especially the development of infrastructure to boost our economic efficiency.

A potentially significant manoeuvre is the establishment of the Future Fund. The Federal Government carries a debt of around $91 billion in unfunded pension liabilities. This is predicted to grow to approximately $140 billion by 2020. In establishing this Fund with an initial contribution of $16 billion, the Government predicts that all unfunded pension liabilities will be erased by 2020.

Taxation

For the third year running, the Budget contains significant tax measures. However, yet again, the opportunity has been missed for reform in lieu of another round of rule changes.

The most significant reform is the reduction in personal tax rates. Costing around $21.7 billion over 4 years, the reform reduces the 17% band to 15% and raise the top tax threshold to $125,000 over 2 years.

For superannuation, there has been a major development. Probably the most ill conceived, poorly targeted, and impossible-to-administer tax that has ever existed, the Surcharge, is to be abolished from 1 July 2005. While this tax was supposedly targeted at high-income earners, all super fund members had to share in the costs incurred by funds complying with this tax. Now that the Government will seize control of the Senate from 1 July 2005, this reform represents a poke in the eye with a suitably blunt stick to a Senate that once had the power to prevent, and always resisted, the reduction of such taxes.

A variety of measures affecting businesses as well as some international changes will also have an impact. The latter includes the introduction of a temporary resident exemption for tax on foreign source income of expatriates.

Impact on owner-managed businesses

This Budget does not deliver significant tax reform to business nor simplify business compliance or red tape. It does however provide significant changes to personal income tax rates, despite failing to attempt to align the corporate and personal tax rates.

Employers may choose to look at current salary packaging with employees, particularly where salary packages are provided to employees who will not be on the top marginal rate of income tax after 1 July 2005. This is because fringe benefits will become more costly, being taxed effectively at the top marginal rate of tax.

While on the topic of salary packaging, employees will also be considering their options under the new Choice of Fund superannuation regime from 1 July 2005. The abolition of the superannuation surcharge levied on contributions to superannuation funds will provide an incentive to high income employees to direct further employer contributions to superannuation funds.

Other Federal Budget measures affecting business include:

- The abolition of the 3% tariff on imported business inputs with no domestic substitutes. Prior to the announcement, relief from the 3% tariff was provided only when free trade agreements were negotiated.
- For superannuation contributions made on or after 1 January 2006, certain late payments of employer superannuation guarantee contributions will be used to offset any part of a corresponding superannuation guarantee charge (SGC) liability that relates to that employee for the relevant quarter.

Economic Outlook

The Australian economy is expected to grow at the rate of 3% of real GDP in 2005-06 after passing through a softer patch of 2% in 2004-05. However, dwelling investment is expected to fall by 2% in both 2004-05 and 2005-06, growth in household consumption will moderate from 4% in 2004-05 to 3 ¼ % in 2005-06, growth in public demand will slow, while business investment growth is expected to remain constant. Strong world demand for commodities will result in solid export growth in 2005-06, however net exports is still expected to retract a further 1% of GDP.

Unemployment is expected to remain around its current level of 5% throughout 2005-06. Wages growth is expected to increase slightly, with the Wage Price Index forecasting growth of 4%.

Inflation is expected to remain within the target band, with CPI forecast to increase by 2¾ % in 2005-06, as petrol prices remain high in the near term.

Major economic parameters (percentage change from previous year)

	Forecasts		Projections		
	2004-05	**2005-06**	**2006-07**	**2007-08**	**2008-09**
Real GDP	2	3	3 ½	3 ½	3 ¼
Employment (a)	2 ¾	1 ¾	1 ½	1 ½	1 ¼
Wages (b)	3 ¾	4	3 ¾	3 ¾	4
CPI	2 ½	2 ¾	2 ½	2 ½	2 ½

a. Labour Force Survey
b. Wage Price Index

The world economy grew by 5.1 % in 2004, its fastest rate in close to 30 years. World GDP growth is forecast to ease to 4¼ % in 2005 and 4% in 2006.

Personal Taxation

Significant personal tax cuts worth $21.7 billion over the next four years have been provided to Australian taxpayers.

The tax cuts are designed to boost income levels and increase the level of participation of Australian taxpayers in the workforce. Increases to the thresholds for the top two marginal tax rates will improve the international competitiveness of the Australia's personal income tax system.

Effective from 1 July 2005 (2005-2006)

- Reduction of the lowest personal tax rate to 15% from 17% (representing a change of 11.7%);

- The following thresholds will be altered:

  - 30% rate : increase to $63,000 (from $58,000);
  - 42% rate : increase to $95,000 (from $70,000); and
  - 47% rate : increase to $95,001 onwards (from $70,001 onwards).

Effective from 1 July 2006 (2006-2007)

- No changes to tax rates;

- The following thresholds will be altered:
  - 30% rate : increase to $70,000 (from $63,000);

  - 42% rate : increase to $125,000 (from $95,000); and

  - 47% rate : increase to $125,001 onwards (from $95,001 onwards).

What does it mean in take home pay?

The table below shows the impact the reductions in income tax will have on take home pay compared to the tax payable in the 2004-2005 year, over a range of incomes.

Taxable income	**Annual tax saving ($)**		**Annual tax saving as a % of tax paid**	
	2005-06	2006-07	2005-06	2006-07
$15,000	$180	$180	13.9%	13.9%
$25,000	$312	$312	7.9%	7.9%
$35,000	$312	$312	4.3%	4.3%
$45,000	$312	$312	3.0%	3.0%
$55,000	$312	$312	2.3%	2.3%
$65,000	$912	$1,152	5.2%	6.6%
$75,000	$1,162	$2,002	5.3%	9.1%
$85,000	$1,662	$2,502	6.2%	9.3%
$95,000	$2,162	$3,002	6.8%	9.4%
$105,000	$2,162	$3,502	5.9%	9.6%
$115,000	$2,162	$4,002	5.2%	9.6%
$125,000	$2,162	$4,502	4.7%	9.7%

Resident individual tax rates– from 1 July 2005

Taxable Income ($)	**Tax Payable ($)**
0 - 6,000	0
6,001 - 21,600	15% of amount over 6,000
21,601 - 63,000	2,340 + 30% of amount over 21,600
63,001 - 95,000	14,760 + 42% of amount over 63,000
95,001 and over	28,200 + 47% of amount over 95,000

Resident individual tax rates – from 1 July 2006

Taxable Income ($)	**Tax Payable ($)**
0 - 6,000	0
6,001 - 21,600	15% of amount over 6,000
21,601 - 70,000	2,340 + 30% of amount over 21,600
70,001 - 125,000	16,860 + 42% of amount over 70,000
125,001 and over	39,960 + 47% of amount over 125,000

Impacts for the SME sector

- A closer alignment of the effective rate of personal tax to imputation credits available on franked dividends means company shareholders can gain access to company funds sourced from franked dividends at a lower tax cost;

- Based on the individual shareholder's tax position, shareholders may be able to obtain a refund of the imputation credit on assessment of their tax return. The effective marginal rates of tax on franked dividend income are detailed in the following table;

Dividend Imputation

Marginal tax rate	0%	15%	18.50%	31.50%	43.50%	48.50%
Franked dividend	$700	$700	$700	$700	$700	$700
Gross-up	$300	$300	$300	$300	$300	$300
Assessable income	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000
Tax payable	$0	$150	$185	$315	$435	$485
Less imputation credit	-$300	-$300	-$300	-$300	-$300	-$300
Tax payable/(refund)	-$300	-$150	-$115	$15	$135	$185
Effective tax rate	-42.86%	-21.43%	-16.43%	2.14%	19.29%	26.43%

- Where a taxpayer receives net income comprising solely of franked dividends, the 2004-05 tax rates permit franked dividends totalling $54,063 to be received (ie $108,126 for a couple) before any tax is payable. This threshold will increase to $60,667 for 2005-06 (ie $121,334 for couples) and $65,022 for 2006-07 (ie $130,044); and

- Utilisation of salary sacrifice and co-contribution amounts will allow for larger amounts to be invested at a lower tax cost than previously available.

Senior Australians

The effect of the reduction in the lowest marginal tax rate to 15% will benefit those Senior Australians eligible for the Senior Australians Tax Offset ("SATO"). Along with the low income tax offset, Senior Australians will now pay no tax where their annual income levels do not exceed $21,968 (for singles) and $36,494 (for couples). These represent an increase from previous income levels of $20,500 (for singles) and $33,612 (for couples).

It is anticipated that the Senior Australian Tax Offset will phase out only once income exceeds the effective tax free threshold for each eligible single or member of a couple.

Medicare Levy

Low-income thresholds increased

The Medicare levy low-income threshold will be increased with effect from 1 July 2004 to $15,902 for individuals (up from $15,592) and to $26,834 for families (up from $26,205).

The additional amounts of threshold for each dependent child or student will be increased to $2,464.

The new thresholds and rates for individuals (from 1 July 2004) will be:

- $0 - $15,902 – nil;
- $15,903 - $17,191 – 20% of excess over $15,902;
- $17,192 + - 1.5% of entire amount.

For pensioners below the age pension, the threshold will rise from 1 July 2004 to $19,252 (up from $18,141).

Recipients of SATO do not pay the Medicare levy until they have an income tax liability. For 2005-2006, as a result of the reduction in the lowest marginal tax rate, the low-income thresholds will be increased to $21,968 for individuals and $36,494 for couples.

Medicare levy surcharge – lump sum in arrears

Concessional treatment will be provided for lump sum payments in arrears in determining a taxpayer's liability for the Medicare levy surcharge. Certain taxpayers who are eligible for the lump sum payments in arrears tax offset and have a Medicare levy surcharge liability may receive a reduction in that surcharge liability.

The measure will apply from the 2005-2006 income year.

Marriage breakdown and CGT rollover

The CGT relief on marriage breakdown will be extended to assets transferred under a binding financial agreement, arbitral award, and binding written agreement. These changes were introduced to reduce the need for involvement of the courts in marriage breakdown settlements.

Two related amendments will also be made.

The first will ensure that marriage breakdown cash settlements do not give rise to CGT.

The second relates to the interaction of marriage breakdown rollover and the CGT main residence exemption. The amendment will ensure that the way in which both the transferor and transferee spouses use a dwelling will be taken into account when determining the transferee spouse's eligibility for the main residence exemption. This change is closing a loophole that allowed a spouse to claim a full main residence exemption in relation to a dwelling transferred from a spouse that did not apply the main residence exemption to the dwelling.

New categories of deductible gift recipients

Five new categories of DGR will be created with effect from 1 July 2006 for approved organisations and funds to cover disaster relief, animal welfare, charitable services and educational scholarships.

Taxpayers will be entitled to claim income tax deductions for certain gifts of money or property to organisations that are endorsed as DGRs under the new categories.

Superannuation

Superannuation surcharge abolished

In the previous budget the Federal Government announced that it would reduce the surcharge to 10% from 1 July 2005. The abolition of the surcharge payable on superannuation contributions and relevant termination payments with effect from 1 July 2005 is a significant change.

The abolition of the surcharge is expected to cost $2.5 billion over the 3 years to 2008-2009. Despite the abolition, those people who benefited from surcharge deferral, eg from defined benefit arrangements, will continue to be exposed to the surcharge when benefits accrue.

The impact of the Surcharge abolition as well as co-contribution benefits, is illustrated below.

$125000 salary for 2005-06

Description	No co-contribution, no salary sacrifice	Co-contribution/Sacrifice SURCHARGE	Co-contribution/Sacrifice NO SURCHARGE
Salary package	125,000	125,000	125,000
Less salary sacrifice	0	-97,000	-97,000
Gross salary	125,000	28,000	28,000
Less PAYG	-44,175	-4,680	-4,680
Net salary	80,825	23,320	23,320
Less undeducted contributions	0	-1,000	-1,000
Less living requirements	-20,000	-20,000	-20,000
Surplus/deficit	60,825	2,320	2,320
Employer contribution (ie sacrificed)	0	97,000	97,000
Less 15% contributions tax	0	-14,550	-14,550
Less superannuation surcharge	0	-9,700	0
Add undeducted contribution	0	1,000	1,000
Add co-contribution benefit	0	1,500	1,500
Add surplus/deficit	60,825	2,320	2,320
Net investable funds	60,825	77,570	87,270
Net benefit from co-contribution/salary sacrifice		16,745	26,445

For the business owner, the Surcharge abolition is very significant. Many business owners have little spare cash for saving until at least their mid-40's due to the capital requirements of their businesses, as well as the need to educate their children and pay off their home mortgages. Due to this, business owners would typically need to make 'catch-up' superannuation contributions late in their careers in an attempt to match the balances of their employed contemporaries. On this basis, they would reach about 50 years of age with limited super. The imposition of the surcharge when contributing in 'catch up' mode was very harsh. As the following table illustrates, the position will now be redressed:

50 Year Old Contributing $100,000 pa, 3% indexed, with 8% pa earnings	
Age 60 balance, 10% surcharge applied	$1,337,651
Age 60 balance, 0% surcharge applied	$1,516,004
Additional Benefits	$178,353 (13 1/3 %)

Super Choices – Your Super, Your Future, Your Choice

The Government will provide additional funding of $88.4m over 5 years to assist with a smooth transition to superannuation Choice of Fund regime that begins on 1 July 2005. The measures will support a comprehensive community education campaign and the superannuation choice-related compliance and enforcement activities of the ATO and ASIC.

Employers have significant obligations to meet to comply with Choice of Fund. You should discuss these matters with your Grant Thornton adviser if you require assistance.

Superannuation guarantee on back payment of wages

The Government intends to ensure employers pay superannuation contributions on salary or wages back-paid to former employees. That is, payments of salary or wages made after the quarter in which the relevant employment relationship ceased.

Currently, an employer superannuation guarantee obligation only arises on salary or wages if the recipient was an employee sometime during the relevant quarter. However, there are instances where payments are made in a quarter after the relevant employment relationship ceased (eg. where a court makes an award based on the underpayment of salary or wages). In these cases, there is currently no obligation on the employer to make superannuation contributions related to those salary or wages.

The Government proposes to amend the superannuation guarantee legislation so that compulsory 9% employer contributions are payable where an amount is paid in a quarter following the termination of an employment relationship. The resulting superannuation guarantee obligation will arise in the quarter in which the back payment is made.

Relief from Double Payment for Employers

The Government intends to reduce the disproportionate penalty on employers who make late superannuation guarantee contributions in an attempt to honour their obligations to employees. The Government will allow certain late payments of employer superannuation guarantee contributions to be used to offset any part of a corresponding superannuation guarantee charge liability that relates to that employee for the relevant quarter.

Currently, employers who make a late contribution to a superannuation fund may end up paying this amount again as the legislation does not allow late contributions to be used to offset the liability to the ATO. This liability includes the unpaid superannuation contribution, interest on that amount and a penalty. Consequently, an employer may effectively pay contributions twice for an individual in respect of the same period.

Under the new arrangements, the Government will allow employer contributions made for an employee to a superannuation provider within 30 days of the superannuation guarantee due date to be used to offset the portion of any superannuation guarantee charge for the quarter that relates to that employee.

Employees will still receive their full superannuation shortfall plus interest to compensate them for the late payment. The arrangements will apply to late payments of contributions made on of after 1 January 2006.

Superannuation contribution splitting between spouses

The Government has reconfirmed its commitment to allowing the splitting of superannuation contributions between spouses. However, the proposed start date has been deferred to 1 July 2006, instead of 1 July 2003 as originally proposed.

Superannuation splitting is intended to allow low income or non-working spouses to accumulate their own superannuation, and gives families more choices in how they prepare for their retirement. Superannuation splitting will be an additional service superannuation funds can choose to offer eligible members.

Under the proposed "annual split" model, after the end of the financial year, a fund member will be able to request that contributions made in the previous year be split with his or her spouse. In effect, the split of contributions will take the form of a transfer of part of the member's benefit to an account for the spouse (either in the same or a different fund). Transfers will be limited to one per year and a fund trustee will be able to refuse an application if it is not made by 1 April in the year following the year the relevant contributions were made.

This payment or transfer will be considered a "contributions-splitting ETP" for the splitting spouse and treated as an ETP rollover for the receiving spouse (ie. a "qualifying ETP"). It is proposed that the splitting spouse will be able to split a maximum of 60% of deducted (or employer) contributions received over the relevant contributions period and up to 100% of undeducted (personal) contributions. Both married and de facto couples will be eligible to participate in contributions splitting. However, existing superannuation contributions and defined benefit interests will not be eligible for splitting.

The limit of 60% on deducted contributions appears unnecessary now that the Surcharge is to be removed. A limit of at least 75% would now be more appropriate.

Business Taxation

Abolition of the 3% tariff on business inputs

The Australian Government will abolish the 3 per cent tariff on business inputs with no domestic substitutes imported under the tariff concession scheme. This measure will be effective from 11 May 2005. Prior to this date, business inputs that did not have domestically produced substitutes attracted a three per cent concessional tariff rate.

Up until now, relief from the 3 percent tariff was only provided as free trade agreements were negotiated. These meant imports from the United States, Thailand and Singapore were not subject to the tariff. From 11 May 2005, imports from all countries will not be subject to the tariff.

This is a sensible policy that will reduce costs to business, without impacting on Australia's commercial competitiveness internationally.

Taxation Treatment of Business Blackhole Expenditure

The Treasurer has announced that the Government will introduce a new provision to address blackhole expenditure.

Blackhole expenditure arises where business expenses are either not recognised under the income tax laws or receive inappropriate treatment under existing provisions.

The provision will be a "provision of last resort" to operate where the expenditure does not have a tax treatment, or is denied a deduction, elsewhere in the tax laws. The new provision will not replace the existing blackhole expenditure provision. This new provision provides a 5 year write off for qualifying expenditure.

Qualifying expenditure will include capital and certain "pre-business" expenditures, not elsewhere recognised in the tax laws, incurred by businesses that are carried on for a taxable purpose.

The new provision will apply for expenditure incurred on or after 1 July 2005.

Treasury had previously called for submissions in relation to this issue in March 2003 when it had been recognised that the present laws were insufficient to address all blackhole expenditures. These changes are seen to be a response to submissions, including those from the Institute of Chartered Accountants outlining the significant inadequacies of the present law.

Franking deficit offset tax rules to be amended

There will be three changes to remove uncertainty and practical difficulties under the current regime:

- franking deficit tax offset penalty will apply only in an income year in which a corporate tax entity franks a distribution for an income year in which a franking deficit arises;
- franking debits arising as a result of the application of a penalty provision in the income tax law will be disregarded when determining the amount of an entity's tax offset arising from its franking deficit tax liability; and
- the full franking deficit tax offset will be allowed where events that caused the excessive over franking were outside of the company's control or were unanticipated, and did not involve any broader exploitation of the imputation system.

Consolidation loss rules

The consolidation loss rules will be modified with effect from 1 July 2002 to allow entities that would have an available fraction of nil, due to rounding, to instead be able to round to the nearest significant digit. The changes overcome an anomaly where a low value entity joins a much higher value with the effect that the current rules would round down the available fraction to zero with the effect that the losses of the low value entity are cancelled.

Extension of tax-timing hedging rules

The Government has extended previously announced reforms of commodity hedging arrangements, which applied to the gold and cotton sectors, to taxpayers in all industries with audited financial accounts.

The reforms to the tax treatment of commodity hedges were originally a recommendation of the Ralph Report and were announced in the 2002/03 budget with an application date of 1 July 2003. This date was deferred in recognition of the potential impact of the application of international financial reporting standards (IFRS) by companies.

These broadened rules will be introduced as part of Stage 3 and Stage 4 of the TOFA tax reforms and are possible due to the adoption of IFRS.

Petroleum Resource Rent Tax amendments

The budget introduced several changes to the Petroleum Rent Resource Tax (PRRT) Legislation with effect from 1 July 2006:

- allow the deduction of transferable exploration expenditure when calculating quarterly instalments and of fringe benefits tax for PRRT purposes;
- allow the deduction of closing-down costs when moving from a production to an infrastructure licence;
- include the PRRT in the self-assessment regime;
- provide roll-over relief for internal corporate restructuring;
- introduce a transfer notice requirement for vendors disposing of an interest in a petroleum project; and
- extend the lodgement period for PRRT annual returns from 42 days to 60 days.

Policy changes to the treatment of data package costs, indirect costs and feasibility assessment costs under the PRRT regime were considered not justified. The treatments of indirect costs and feasibility assessment costs, an administrative solution should be explored before any legislative amendment is considered.

Gas Transfer Pricing Regulations

Adjustments to the proposed Gas Transfer Pricing Regulations will be made to improve taxpayer certainty and simplify the calculation of a gas transfer price for an integrated gas-to-liquids project. Specifically, the method used to calculate the capital allowance rate in the proposed Regulations will be changed from a weighted average cost of capital approach to the long-term bond rate plus seven percentage points approach. Technical changes will also be made to the proposed Regulations dealing with the materiality threshold for apportioning costs and the endpoint of the downstream stage of a project.

Plantation forestry prepayments

In a measure illustrating the power of the timber lobby, the "12 month rule" which applies to the forestry prepayments concession will be extended until 30 June 2008 to allow the concession to be reviewed. Under the concession, certain prepaid expenditure that is invested in timber plantation managed investment schemes is excluded from the general prepayment rules. The exclusion allows investors to obtain an immediate deduction for funds contributed in one financial year for agronomic activities undertaken during the following year. Since 1997 over $4 billion has been invested in 600,000 hectares of new plantations, with a target of 3 million hectares by 2020. It would appear that the olive tree grove is not so well connected.

Income tax and GST exemptions for Asian Development Bank Staff

To coincide with the opening of an ADB office in Australia, the Government has announced that it will extend the tax exemption that applies to salary and emoluments received by non-Australian citizen ADB staff to all ADB staff.

The Government also plans to allow ADB staff to import personal effects (including furniture) free of GST when first taking up a post in Australia.

These changes will take effect from the date of assent of the enabling legislation or regulations.

Proposed changes not to proceed

The Government announced that it would not pursue the following proposals:

- Rationalised treatment for partnerships and joint ventures; and
- A generic regime for the taxation of rights and intangibles assets.

We have been spared further complexity being added to the 12,000 pages of the Tax Act – small mercies!

International Taxation

In furtherance of the Government's aim of enhancing Australia's status as an attractive location for international business and investment, it has announced the following tax measures:

- A significant reduction in the application of Australia's CGT regime to non- residents of Australia
- A tax exemption on foreign source income for temporary residents of Australia
- Some relief from taxation of non-residents under employee share and option plans
- Removal of foreign loss and foreign tax credit quarantining

Significant reduction in the CGT regime applicable to non-residents

Currently, Australia's CGT regime essentially applies to disposals of a range of Australian assets owned by a non-resident, including shares in Australian private companies. This deters non-residents from investing in Australia. Therefore, the Government has decided to limit the application of the CGT regime to non-residents to:

- Australian real property; and
- the business assets of Australian branches of a non-resident.

An anti-avoidance measure will protect the integrity of these rules by applying CGT to non-portfolio interests in interposed entities (including foreign entities), the value of which relates wholly or principally to Australian real property. It should be noted that the definition of "real property" will extend to other assets having a physical connection with Australia, such as mining rights and other interests related to Australian real property.

With the other international tax changes announced or implemented over the last two years, Australia will now be looked at far more favourably as a place for foreigners to invest. This gives us a significantly higher global profile as a location in which to invest in, or base foreign investment from.

These tax changes will generally apply to CGT events occurring on or after the date on which legislation introducing the measure receives Royal Assent. The date from which the anti-avoidance measure will apply is unclear.

Foreign source income exemption

More specifically, the measure will apply to individuals who are temporary residents for up to four years. The changes will:

- exempt foreign source income of the temporary residents;
- ensure that no capital gain or loss would arise on the disposal of foreign assets by them;
- remove interest withholding tax obligations; and

- extend the existing four-year exemption from the foreign investment fund (“FIF”) rules.

These measures may reduce the cost of Australian employers employing temporary residents where the increase in tax burden to the employee by working in Australia is currently borne by the employer.

The measure will have effect from the first income year after the date of Royal Assent .

Employee share and option plans

The Government will not proceed with a previously proposed measure to treat the cessation of Australian tax residency status as a point for taxing benefits received under employee share and option schemes. The changes are proposed to apply to shares or rights acquired on or after the date on which the enabling legislation receives Royal Assent. This is consistent with recently announced reforms in this area that have provided that:

- income assessed under the employee share scheme provisions, like other employment income, is generally able to qualify for existing exemptions for offshore employment
- amounts are not assessable under the employee share scheme provisions to the extent that the share or right acquired relates to relevant employment offshore while the employee was not an Australian resident.

Removal of foreign loss and foreign tax credit quarantining

The Government will simplify the foreign source income rules by removing foreign loss and foreign tax credit quarantining. The measure will allow foreign losses to be deducted from domestic income and will eliminate the need for foreign tax credits and revenue losses to be quarantined into separate classes.

The current foreign loss and foreign tax credit quarantining rules prevent taxpayers from:

- applying foreign losses against domestic income; and
- receiving credit for foreign tax in excess of the Australian tax payable on assessable foreign income.

Instead, they require taxpayers to carry forward foreign losses and excess foreign tax credits to be applied against future assessable foreign income (or tax thereon) of the same class.

The measure will reduce compliance costs for Australian multinationals, regional headquarters, managed funds, investors and small businesses expanding offshore. It will also assist taxpayers by not taxing their domestic income when they suffer an overall worldwide loss.

These changes will apply to income years beginning on or after Royal Assent.

Impact on controlled foreign companies (“CFC”)

In addition, taxpayers that earn ‘attributable income’ through CFCs will no longer:

- need to quarantine the revenue losses of their CFCs into separate classes
- have tainted capital losses of listed country CFCs excluded from the calculation of eligible designated concession income

However, a CFC’s tainted capital losses will continue to be quarantined from its other income. Also, CFC losses will continue to be quarantined in the CFC that incurred them.

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