2006-07 Federal Budget Summary

Grant Thornton

Snapshot of major tax proposals
Economic review and key policies
Personal tax proposals
A super plan
Major business tax proposals
Contact details and disclaimer

Welcome to the 2006-07 edition of Grant Thornton's Federal Budget Summary. On 9 May 2006, the Federal Treasurer, the Hon Peter Costello, handed down his 11th Federal Budget. It predicts continued strong economic growth in Australia.

The Treasurer announced significant tax changes to the treatment of superannuation, and went some way towards reforming tax rates. He also implemented most of the proposals recommended to him for changes to our small business tax concessions, and increased the diminishing value rate for new plant acquired by Australian businesses from 10 May 2006.

From a policy perspective, although additional expenditure was announced for roads, rail and water conservation, there are continuing challenges for an economy facing capacity constraints after a long period of conservative surplus budgets in which infrastructure investment has been limited.

Expenditure on education and support of research and development has increased, given the perceived need to encourage innovation as Australia's long term competitive advantage. However, in this regard Australia faces the challenges represented by China and India's increasing competitiveness in knowledge intensive fields such as design, engineering and architecture.

This report focuses on key personal and business tax changes. While some information has been included on the proposed changes to our superannuation system, those proposals are very significant, and will be the subject of much greater scrutiny and reporting as the proposals are implemented. Details of all the measures are contained in a further report released today.

Pictured left: Bernie O'Neill, Managing Director of HMP Constructions Pty Ltd - a rapidly growing mining and civil contracting company. In this document we discuss the implications of the Budget for business owners like Bernie.

Close
Next Page ▶

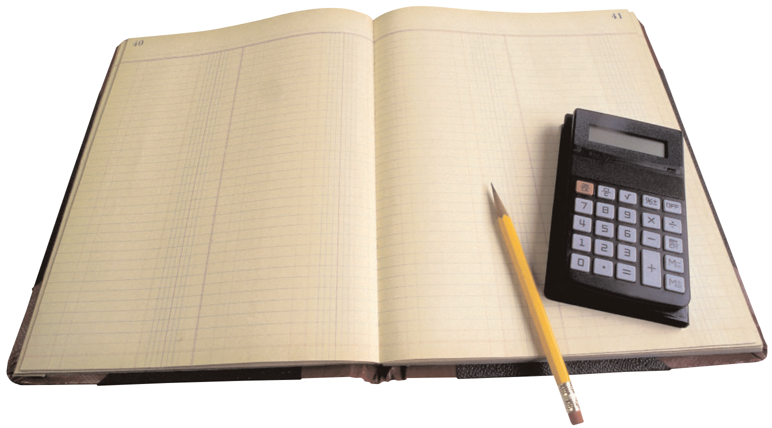
Snapshot of major tax proposals

Personal taxation

- New personal tax rates to apply from 1 July 2006: only 2% of taxpayers will pay the top marginal tax rate of 46.5%
- Family tax benefits have increased
- Low income tax offset has increased
- High wealth individuals: there is more funding for Australian Taxation Office (ATO) audits

Superannuation (proposed from 1 July 2007)

- Plan to simplify superannuation: major changes announced
- Superannuation: age base deduction limits to change to $50,000 for all
- Reasonable benefit limits to be removed
- Undeducted contributions: $150,000 annual limit



Business taxation

- Capital allowances: increase in the diminishing value rate for new plant
- Major changes to small business concessions
- FBT rate reduced to 46.5% from 1 April 2006
- Mining, petroleum and quarrying rights: depreciation amendments
- Venture capital incentives increased
- Family Trust Election restrictions to be eased - details still to come
- Boat hire businesses: claiming deductions will be made easier

Economic **review** and **key** policy highlights

Economic growth

- Growth is predicted to be 3.25% in 2006/07
- Export growth is expected to pick up, from 2% to 7%, with imports set to rise from 6% to 7% of GDP
- Current account deficit is $62.5 billion, being 6.25% of GDP

Fiscal outlook

- The Budget provides for an underlying cash surplus of $10.8 billion (1.1% of GDP), a decrease from the 2005/06 surplus of $14.8 billion (1.5% of GDP)
- Economy is now a $1 trillion a year economy
- Inflation forecast is 2.75%

Employment

- Unemployment levels are at a 30 year low of 5.25%
- Employment growth is 1%; wages growth is 4%
- Employment levels are at an all time high: participation rate is 64.25%

Personal tax proposals

Personal taxation

The taxation centrepiece of the Budget for many Australians will be the tax cuts. Tax rates and thresholds were reduced for taxpayers at both ends of the scale, with relief focused on high-income earners.

Resident individual tax rates - from 1 July 2006

Taxable income ($)	Tax payable ($) (excluding the Medicare levy)
0 – 6,000	0
6,001 – 25,000	15% of amount over 6,000
25,001 – 75,000	2,850 + 30% of amount over 25,000
75,001 – 150,000	17,850 + 40% of amount over 75,000
150,001 and over	47,850 + 45% of amount over 150,000

Non-resident individual tax rates - from 1 July 2006

Taxable income ($)	Tax payable ($)
0 – 25,000	29%
25,001 – 75,000	7,250 + 30% of amount over 25,000
75,001 – 150,000	22,250 + 40% of amount over 75,000
150,001 and over	52,250 + 45% of amount over 150,000

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, over a range of incomes.

Taxable income	Annual tax saving ($)	Annual tax saving as a % of tax paid
	2006/07	2006/07
$10,000	365	100.0
$15,000	365	32.7
$20,000	365	16.9
$30,000	910	17.1
$40,000	510	6.0
$50,000	510	4.4
$60,000	510	3.5
$70,000	1,350	7.2
$90,000	2,250	8.2
$125,000	4,460	10.1
$150,000	6,200	11.0

Personal tax proposals (cont)

Impacts for the SME sector and investors

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 imputation credits on assessment of their tax return.

Where a taxpayer receives net income comprised solely of franked dividends, the 2006-07 tax rates permit franked dividends totalling $73,956 to be received (i.e. $147,912 for a couple) before any tax is payable.

Furthermore, an individual taxpayer can earn up to $121,500 before his or her average rate of tax is equal to the corporate tax rate of 30%.

Other

There were also increases in:

- Senior Australians Tax Offset thresholds
- the Low-Income Tax Offset, which is to increase from $235 to $600
- Medicare levy low-income thresholds
- the ATO's funding for the high net worth individual review

A super plan

Strategy	Change	Impact
Undeducted contributions	This very popular strategy will be restricted to $150,000 pa, rather than the current unlimited approach. A three-year averaging rule may apply for larger amounts.	This will significantly hamper your ability to shift wealth to superannuation. It will also make it less attractive for expatriates to retire to Australia. If you are going to sell your business after 1 July 2007, this limit will hamper your ability to reduce your net worth in order to meet the small business threshold.
Age-based limit contributions (over $100k if over 50)	Deductible contributions to be limited to $50,000 cap.	The measure promotes use of super from a younger age, for those who can afford it. Capital-starved business owners will be disadvantaged as they typically lack the free cashflow to contribute early in life. A transitional rule, which will provide a $100,000 limit to over 50 year-olds until 2011-12, will benefit some, but the weakness will prevail after this time.
Multiple super deductions	The top marginal tax rate will apply to deductible contributions exceeding the $50,000 limit.	If you have multiple unrelated employers or you can enjoy both an employer contribution and a self-employed contribution, the benefits of such approaches may be reduced or negated.

Ten years of dust was blown off a reform package originally mooted soon after Mr Costello became Treasurer. Now "A Plan to Simplify and Streamline Superannuation" is open for comment, with submissions closing on 9 August 2006. If implemented, the Plan would represent a major structural reform of the retirement incomes system. The key reform is that our current three-tiered approach to taxing benefits is to be reduced to a two-tiered approach. While benefits will continue to be taxed during the contributions phase and the earnings phase, tax will no longer apply during the withdrawal phase for people aged 60 and over.

Consistent with this, the complex Reasonable Benefit Limits system will be removed. Instead, limits would be imposed upon entry to the system.

If implemented, a number of key approaches to retirement planning will need a rethink. These are included in the table to the left.

A **super** plan (cont)

Reduced 'red tape'

A big advantage of the Plan is the removal of considerable "red tape" from the retirement planning process. This includes that the very significant effort currently required to assess tax issues in the retirement or withdrawal phase will no longer be required for over 60's. Instead, the effort can be better targeted at ensuring that the retirement benefits are structured to meet the precise needs of the member and their dependents.

Are the limits enough?

The accompanying graph below illustrates the shortfall in retirement funding that may arise due to the new cap on contributions. The graph compares the position of a 45 year old who contributes to the maximum allowed over 15 years, under either the current age-based rules or the proposed $50,000 annual cap. An 8% pa earning rate has been assumed. At age 60, the person will commence a pension, which is assumed to generate the same after-tax amount under both options. The difference is obviously marked. Suffice to say, having a structure that permits an individual's retirement nest egg to virtually disappear by age 75 is hardly ideal given Australia's ageing population base.

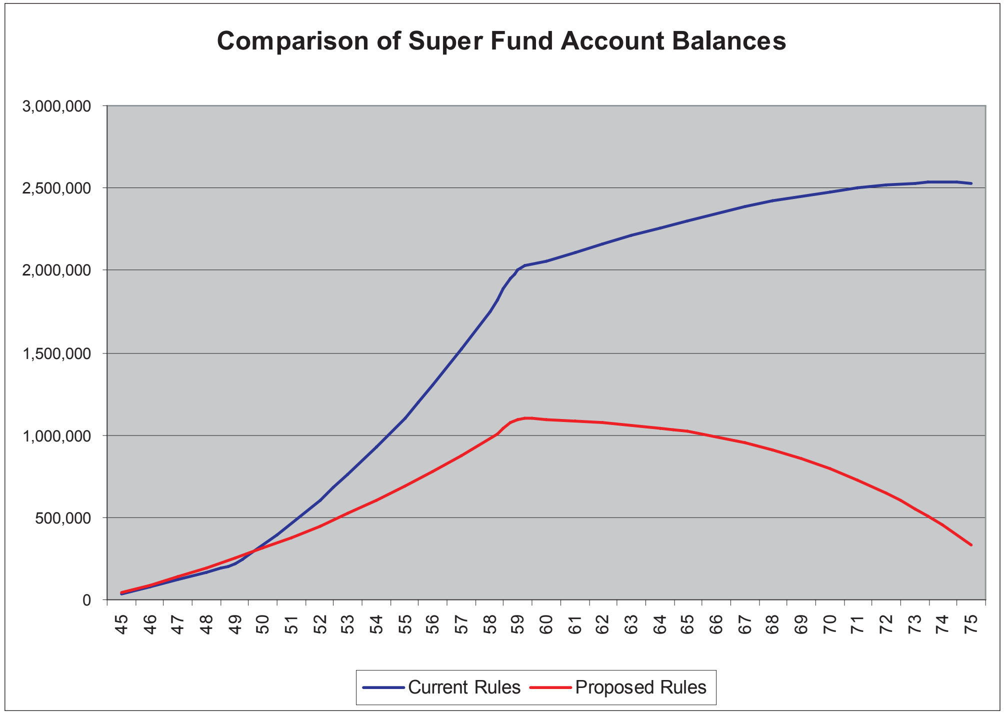
Transitional rules

If the Plan is implemented, almost all measures will commence on 1 July 2007. One exception is that the restrictions on undeducted contributions are intended to be backdated to Budget Night - i.e. 9 May 2006. This "legislation by Press Release" is unfortunate as it puts retirees at great uncertainty about whether to proceed with this effective strategy while the Government makes up its mind about whether to proceed with the Plan at all and, if so, in what form.

Where to from here?

This Plan is merely a proposal. Therefore, in the absence of further announcements, the approach to 2006 year end planning must be "business as usual". You should discuss this with your Grant Thornton adviser, especially if you intend to make undeducted contributions or plan to retire or sell your business before 1 July 2007.

If you require more details about the features of the Plan, please contact your Grant Thornton adviser or e-mail super@gtqld.com.au.



Major **business** tax proposals

Small business

The Government has announced a number of measures that they consider will assist small businesses by improving the alignment of eligibility thresholds for, and increasing access to, the Simplified Tax System (STS) and small business Capital Gains Tax (CGT) concessions. The measures include:

- an increase in the net assets threshold for the CGT small business concessions from $5m to $6m. This measure will apply from 1 July 2007
- allowing STS taxpayers to be eligible for the CGT small business concessions without having to satisfy the net assets threshold. This measure will apply from 1 July 2007
- access to the small business CGT concessions being improved by replacing the current 50% controlling individual test with a more generous 20% significant individual test. The significant individual test will be satisfied either directly or indirectly through one or more interposed entities. This change will apply to CGT events that occur from the 2006-2007 income year.

Capital allowances - increase in rate of depreciation

The Government intends to increase the rate of tax depreciation where the diminishing value rate (DVR) is applied. The amendment will apply to depreciable assets acquired on or after 10 May 2006.

Currently, the law allows for the determination of the DVR by applying 150% to the straight line rate of depreciation. The proposed change will increase that rate to 200%. This change will allow businesses to write off the cost of plant and equipment more rapidly, thereby reducing the cost of the investing in depreciable assets over their effective lives.

The simplified depreciation arrangements under the Simplified Tax System and low value pools will not change.

Major **business** tax proposals (cont)

Family trust elections

Family trust and interposed entity elections will be able to be revoked in certain limited but unspecified circumstances.

The definition of family group will be broadened to include lineal descendants and where distributions are made by a family trust to former spouses, widows or widowers of family group members who have new spouses.

There were also reforms to the following areas:

- FBT: including aligning the FBT rate with the top marginal tax rate (i.e. 46.5%) from 1 April 2006
- taxation of employee share schemes
- capital write-offs available to the resources sector
- research and development: some compliance aspects were relaxed
- venture capital: some aspects of the existing incentives were restructured and a new vehicle for early stage venture capital is to be created
- international taxation: amendments included measures to streamline taxation of non-resident beneficiaries of trusts

Other measures

Reforms were also announced that effected the following areas:

- philanthropic measures: a number of changes were made to promote philanthropy
- plantation forestry industry: changes are proposed to effect manged investment schemes in the forestry industry
- GST: measures were announced that effected GST treatment of vouchers and real estate as well as to align the definition of small businesses for GST purposes with that of the STS

Contact details and disclaimer

Adelaide
Malcolm Wight
Level 1
67 Greenhill Road
Wayville SA 5034
T 08 8372 6666
F 08 8372 6677
E info@gtsa.com.au

Brisbane
Peter Godber
Grant Thornton House
King George Square
102 Adelaide Street
Brisbane QLD 4000
T 07 3222 0200
F 07 3222 0444
E info@gtqld.com.au

Paul Banister
Grant Thornton House
King George Square
102 Adelaide Street
Brisbane QLD 4000
T 07 3222 0200
F 07 3222 0444
E info@gtqld.com.au

Melbourne
Lisa Difford
35th Floor, Sth Tower
Rialto Towers
525 Collins Street
Melbourne VIC 3000
T 03 9611 6680
F 03 9611 6666
E info@gtvic.com.au

Perth
Peter Fallon
Level 6
256 St George's Terrace
Perth WA 6000
T 08 9481 1448
F 08 9481 0152
E info@gtwa.com.au

Sydney
John Ross
Level 17
383 Kent Street
Sydney NSW 2000
T 02 8297 2566
F 02 9299 4445
E info@gtnsw.com.au