

# 2007-08 **Federal Budget** Summary

Grant Thornton 

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Welcome to the 2007-08 edition of Grant Thornton's Federal Budget Summary. On 8 May 2007, the Federal Treasurer, the Hon Peter Costello, handed down his 12th Federal Budget. It predicts continued strong economic growth in Australia of 3.75%.

The Treasurer continued with his policy of returning increasing tax revenues to individual taxpayers focusing this year on tax cuts to low income earners. In a surprise move he also proposed an increase in the top tax threshold from 1 July 2008 to increase Australia's tax competitiveness from 20th in 2004-05 to 8th in the OECD based on the top threshold relative to the average wage.

The skills shortage has received attention with some long overdue funding to the education sector with a number of measures to enhance the quality of training and the remuneration of teachers.

On the other big issues facing the economy – transport, ports infrastructure and environment, the new commitments were small reflecting the long lead times that it will take to address those issues. The water plan already announced also attracts little funding in 2007-08.

The strategy adopted is one of economic discipline, appropriate in an economy running at near to full capacity. A budget surplus of 1% of GDP is slightly less than the actual surplus of 2006-07 and is intended not to put too much demand pressure on inflation and interest rates. However, with \$5 billion of tax cuts focused on low income earners a significant impetus to consumption of basic goods should provide a boost to companies supplying those consumers.

The defence industry, solar power and rainwater tanks, are the big industry winners. The 'vision thing' is probably still to come in a pre-election announcement.



## Economic Review and Key Policy Highlights

### Economic growth

- Growth is predicted to be 3.75% in 2007-08
- Export growth is expected to pick up, from 3% to 5%, with imports set to fall from 8.5% to 6.5% of GDP
- Current account deficit is \$65 billion, being 6.0% of GDP
- Business investment is at highest level of GDP in 32 years  
Grown more than 70% in the last 4 years

### Fiscal Outlook

- The budget provides for an underlying cash surplus of \$10.6 billion (1.0% of GDP), 2006-07 actual surplus of \$13.6 billion (1.3% of GDP)
- Inflation forecast is 2.5%

### Employment

- Unemployment levels are at a 30 year low of 4.75%
- Employment growth is 1.5%; wages growth is 4.25%
- Employment levels are at an all time high: participation rate is 64.8%

### Future Fund

- \$52 billion by June 2007; unfunded super liability \$148 billion by 2019-20
- \$5 billion into higher education endowment fund from 2006-07 surplus

## Snapshot of Major Tax Proposals

### Personal Taxation

- New personal tax rates to apply from 1 July 2007: over 80% of taxpayers will face a top marginal tax rate of 30% or less
- A taxpayer will need to earn \$134,000 to pay an average rate of 30% in 2008-09
- Low income tax offset has increased to \$750, dependant spouse rebate and Medicare levy low income thresholds will be increased
- Childcare benefit and rebate changes
- Dependant spouse rebate has increased

### Business Owners Taxation Change

- GST: Increase in GST registration turnover threshold
- GST: Increase in threshold for approved tax invoice
- GST: simplified accounting methods
- Annual payment of PAYG instalments when voluntarily registered for GST
- Establishment costs for carbon sink forests

### Business Taxation

- Company loss recoupment rules – SBT \$100m cap removed
- Consolidation amendments
- Thin capitalisation changes
- Further venture capital concessions
- Petroleum resource rent tax changes

### Wealth Management Issues

- Co-contribution super bonus for 2006 payments
- Trading of forestry MIS Schemes
- New tax incentives for film production
- Public Offer Funds

# Personal Taxation Proposals

The taxation centrepiece of the Federal Budget refers to personal taxation measures. Further significant tax cuts were announced. Thresholds will be raised in 2 steps and low income tax offsets have increased, aimed at improving work incentives and benefiting part-time workers.

## Effective from 1 July 2007 (2007-08)

From 1 July 2007, there will be:

- An increase in the 30% threshold to \$30,001 (from \$25,001)
- An increase of the low income tax offset (LITO) from \$600 to \$750 per year and phase out from \$30,000, with creation of an effective tax-free threshold of \$11,000 for low income earners
- No tax on annual income up to \$25,867 for singles and \$43,360 for couples for Senior Australians who are eligible for Senior Australian Tax Offset

## Proposed income tax rates: 1 July 2007 – 30 June 2008

Resident		Non-Resident	
Taxable Income (\$)	Tax Payable (\$)	Taxable Income (\$)	Tax Payable (\$)
0 - 6,000	Nil	0 - 30,000	29%
6,000 - 30,000	Nil + 15% of excess over 6,000	30,001 - 75,000	8,700 + 30% of excess over 30,000
30,001 - 75,000	3,600 + 30% of excess over 30,000	75,001 - 150,000	22,200 + 40% of excess over 75,000
75,001 - 150,000	17,100 + 40% of excess over 75,000	150,001 +	52,200 + 45% of excess over 150,000
150,001 +	47,100 + 45% of excess over 150,000		

## Effective from 1 July 2008 (2008-09)

From 1 July 2008, there will be:

- An increase in the 40% threshold to \$80,001 (from \$75,001)
- An increase in the 45% threshold to \$180,001 (from \$150,001)

## Proposed income tax rates: 1 July 2008 – 30 June 2009

Resident		Non-Resident	
Taxable Income (\$)	Tax Payable (\$)	Taxable Income (\$)	Tax Payable (\$)
0 - 6,000	Nil	0 - 30,000	29%
6,000 - 30,000	Nil + 15% of excess over 6,000	30,001 - 80,000	8,700 + 30% of excess over 30,000
30,001 - 80,000	3,600 + 30% of excess over 30,000	80,001 - 180,000	23,700 + 40% of excess over 80,000
80,001 - 180,000	18,600 + 40% of excess over 80,000	180,001 +	63,700 + 45% of excess over 180,000
180,001 +	58,600 + 45% of excess over 180,000		

## Medicare levy

The following changes will apply from 1 July 2006 (2006-07):

- An increase in the 1.5% Medicare levy low income threshold to \$16,740 (from \$16,284) for individuals and \$28,247 (from \$27,478) for families
- An increase of the additional amount of threshold for each dependant child or student to \$2,594 (from \$2,523)
- An increase of the Medicare levy low income threshold for pensioners below Age Pension age to \$ 21,637 (from \$19,583)

## Child care benefit

Effective from 1 July 2007 (2007-08)

From 1 July 2007, there will be

- An increase of the Child Care Benefit (CCB) by 10%, on top of indexation – As a result a family on maximum rate CCB with one child in Long Day Care for 40 hours per week will receive \$134.80 per week – an extra \$16.40 (13.85%)
- A conversion from the existing Child Care Tax Rebate (CCTR) to a direct payment – As a result families will receive the CCTR as a direct payment (up to \$4,200 per child) shortly after the year in which they incur child care costs – Families will still receive a rebate for out of pocket costs incurred in 2005-06 under the existing arrangements – Accordingly, families with out of pocket costs for both 2005-06 and 2006-07 will receive two rebates in 2007-08 (i.e. one through the tax system, and one as a direct payment)

# Wealth Management



The question arises for those planning their tax position for this year will the Government repeat this for next year's budget (May 2008) after an election in November 2007?

## Superannuation

For those who are lucky enough to have made the co-contribution for the year ended 2006, the Government undertakes to double up the Government co-contribution from a maximum of \$1,500 to a maximum of \$3,000. This measure is retrospective and applies only for the year ended 30 June 2006.

The rules for co-contribution to be granted by the Government are such that those with assessable income and reportable fringe benefits of \$28,000 or lower are entitled to the maximum rate of co-contribution normally 1.5 times their personal contribution. Now with the additional budget bonus, it is 3 times their personal contributions.

The question arises for those planning their tax position for this year will the Government repeat this for next year's budget (May 2008) after an election in November 2007?

## Management Investment Schemes (MIS)

Following on the previous Treasury announcements regarding Management Investment Schemes (MIS), the government has announced it will allow trading of interests in Forestry MISs, subject to a minimum 4 year holding period which applies for initial investors only. This means that investors who invested in a forestry MIS prior to 1 July 2003 will be able to trade their interest as of 1 July 2007 when the 4 year holding period will become operational.

This concession will allow trading of both existing and future interests and will be effective from 1 July 2007. It overcomes the current difficulty in trading forestry interests whereby the Government was reluctant to allow trading when an upfront 100 per cent tax deduction had already been allowed to the initial investor.

## New Tax Incentives For Film Production

As from 1 July 2007, the Government has proposed new refundable tax rebates.

- A Producer Rebate providing:
  - a 40% rebate for eligible domestic feature films
  - a 20% rebate for other eligible domestic media productions (TV series and documentaries)
- A 15% location rebate for eligible international films.
- Post production and effects will be eligible for tax rebate

## Public Offer Funds

The previous arrangements whereby public offer funds require the new employer of an existing member to sign a "participating employer" agreement will be outlawed by the Government. This will allow employees to choose to remain in an existing fund following a change of employer. It applies from 1 July 2007 and simplifies portability.

# Corporate Tax

## Recoupment of company tax losses

The recoupment of company tax losses has always been subject to the satisfaction of one of two tests. Firstly, the Continuity of Ownership Test, or, alternatively, the Same Business Test.

In 2005 significant changes were made to the company tax loss provisions which made the Continuity of Ownership Test easier to satisfy for widely held groups. In making such changes the Government capped the application of the Same Business Test to companies with a turnover of less than \$100m.

The effect of this change was a significant reduction in private investment in public utilities and infrastructure.

The Treasurer has announced that this cap will be removed and the Same Business Test will once again apply for all taxpayers.

Further changes to both the Continuity of Ownership Test and the Same Business Test have also been announced to remove various uncertainties and improve the operation of the provisions. These proposals include:

- Ensuring companies do not fail the Continuity of Ownership Test for simply having multiple classes of shares, or having special

arrangements in place that distribute dividend and capital in particular ways;

- “Voting Power” to include the power to vote on a poll for the election of a director;
- Ensuring the entity history rule under the tax consolidation regime is disregarded in applying the Same Business Test.

We welcome the changes being proposed by the Treasurer in this regard.

## Consolidated Groups

It has been announced that detailed changes will be made to the tax consolidation regime as it applies to both consolidated groups and multiple entry consolidated groups (MEC groups). These changes are predominantly addressing legislative complexities regarding the tax cost setting rules and clarify interactions between the consolidation regime and other parts of the income tax law.

A note of complexity regarding these rules is that some measures are to apply from 1 July 2002 and others to apply after 8 May 2007.

Some of the proposed measures range from clarifying the requirement of accounting principles on the cost setting

process and valuation of liabilities, to the phasing out of over-depreciation deductions and the removal of CGT event L7.

## Thin capitalisation

### Use of A-GAAP accounting standards: extended by one year

The Government has announced an extension of the transitional period by another year for an election to adopt A-GAAP accounting standards for thin capitalisation valuation purposes.

This extends the transitional period to 4 years and is intended to allow for further consultation regarding a long term response to the effect on thin capitalisation and the adoption of Australian equivalent International Financial Reporting Standards.

## Finance leasing – taxation treatment to remain unchanged

The Government has confirmed that the tax treatment of finance leases between taxable entities will remain unchanged, and that the Ralph Report recommendations will not be adopted (the Ralph Report proposed to apply a sale and loan treatment to certain finance leases). This decision will mean that finance leases will be excluded from the scope of forthcoming legislation for the taxation of financial arrangements.



### Venture capital – improved taxation treatment

The eligibility requirements for concessional taxation treatment for foreign residents investing in venture capital limited partnerships (VCLPs) and Australian venture capital funds of funds (AVCFOFs) will be further relaxed from the 2007-08 income year.

The concessional tax treatment for foreign resident investors will be extended to allow:

- up to 20% of committed capital in VCLPs and AVCFOFs to be invested in companies and unit trusts that are not located in Australia; and
- eligible partners in conditionally registered VCLPs and AVCFOFs that become fully registered to be entitled to a tax exemption on the profits and gains derived from investments made while the partnership was conditionally registered.

To ensure that investments made by early stage VCLPs are directed at early stage venture capital activities, a partnership can acquire pre-owned investments in an entity only if:

- it already owns an investment in the entity, or it will also be making investments, that are not pre-owned investments in the entity at the same time; and
- the total value of the partnership's pre-owned investments does not exceed 20% of its committed capital.

### Petroleum resource rent tax – minor policy issues

The Government will implement three policy changes to the petroleum resource rent tax (PRRT) rules. With effect from 1 July 2008, it will:

- Introduce a functional currency rule similar to the rule in the income tax provisions.
- Introduce a 'look-back' rule for exploration expenditure relating to production licences derived from exploration permits and retention leases. This will ensure that all exploration expenditure is deductible for PRRT purposes where a production licence is derived from an exploration permit or a retention lease on or after 1 July 2008.
- Treat a tolling fee received as a PRRT receipt and the expenses incurred to process the petroleum as a deduction, where a petroleum project processes petroleum sourced from another petroleum project for a tolling fee.

# Business Owners

## GST

Changes to GST aimed at assisting small business have been introduced. Some of these have been harmonised with PAYG changes.

### Increase in GST Registration Threshold

Compulsory registration threshold \$75,000

Compulsory registration threshold for non-profit entities \$150,000

This takes effect from 1 July 2007.

Entities that choose to voluntarily register for GST have the option of remitting GST annually.

Taxpayers that remit annually for GST will, from 1 July 2008, be able to pay PAYG instalments annually. This gives an opportunity for small business to complete one BAS a year for GST and PAYG.

## Tax Invoices

Input tax credits can be claimed without a tax invoice for purchases up to \$75 (\$82.50 including GST). This is an increase from \$50.

For purchases of \$75 or less, businesses will be able to rely on the same record keeping for GST and income tax purposes.

The no-ABN withholding threshold has also been increased to \$75

This takes effect from 1 July 2007

## Simplified GST Calculation

Currently only charities and food retailers can use simplified accounting methods (SAMS) if they have mixed (taxable and tax-free) purchases or sales. From 1 July 2007 any businesses with a turnover less than \$2 million can use a simplified method to calculate GST using a method agreed with the ATO.

GST changes require the unanimous agreement of the States and Territories to implement them.

## Rural Business Owners

### Establishment costs for carbon sink forests

Farmers and other landowners will be allowed to depreciate the costs of establishing a qualifying carbon sink forest under the horticultural plant provisions, with effect from 1 July 2007.

In addition, the Government will introduce immediate deductibility for costs incurred in establishing a qualifying carbon sink forest during a five-year period commencing 1 July 2007. The immediate deduction will take precedence over the general horticultural provisions during this period. Deductions under this measure will not be available to carbon sink forests established through managed investment schemes.

To be eligible for tax deductibility, businesses establishing carbon sink forests will need to participate in the Government's Greenhouse Challenge Plus programme.

Entities that choose to voluntarily register for GST have the option of remitting GST annually.





## Environment

The growing emphasis on the environment was evident in Costello's speech and the related press releases highlighting future spending on environmental issues. However, the many initiatives highlighted in the budget contain little by way of new measures and little by way of immediate spending on pressing environmental issues. Rather, the budget highlights future commitments to initiatives previously announced by the Government.

With that said, new initiatives announced include the following:

### Australian Centre for Climate Change Adaptation

\$126m over the next five years has been earmarked for the establishment and management of the Australian Centre for Climate Change Adaptation that will seek to better understand the effects of, and to develop methods to adapt to, climate change.

### Coal mine methane reduction

A total of \$18.5m (of which \$15.9 has previously been allocated for) over the next five years has been allocated for the reduction in methane emissions from coal mines. The funding will be provided to mining companies on a competitive basis.

### Expansion of photovoltaic (solar panel) rebate programme

The rebate programme which is in place to encourage households to install photovoltaic solar panels will now be lifted from a maximum of \$4,000 to \$8,000.

### Community water grants

Competitive grants of up to \$50,000 will be available to community organisations and schools for the installation of rainwater tanks, water meters and water saving taps and toilets.

### Environmental stewardship programme

\$50m over the next four years will be allocated to private landowners in an attempt to safeguard 'environmental assets'.

### National Heritage Trust phase three

From 2009, \$2 billion will be allocated over five years to continue the work National Heritage Trust in relation to restoration and conservation of Australia's environmental and natural resources.

### Environmental Protection and Biodiversity Conservation Act – enhanced administration

Funding of \$70.6m over four years will be used to improve the administration of this Act by the Department of the Environment and Water Resources.

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