# 2008-09 Federal Budget Summary

**14 May 2008**

Welcome to the 2008-09 edition of Grant Thornton's Federal Budget Summary. On 13 May 2008, the Federal Treasurer, the Hon Wayne Swan, handed down his 1st Federal Budget.

Against a background of the international credit crunch and rising interest rates, the first Federal Budget of new Treasurer Wayne Swan delivers a larger than expected $21.7 billion surplus for 2008-09 that is designed to reduce the demand pressures fuelling inflation despite the largest projected increase in the terms of trade in 50 years.

However, given the forecast nominal GDP growth of 9.25% this Budget does little to restrict the juggernaut that is the Australian economy on Chinese steroids.

Previously announced tax cuts to individuals are retained to encourage greater workforce participation. The Government reaffirmed its commitment to reduce rates to three (15%, 30% and 40%) by 2013-14.

The measures to improve infrastructure to boost the productivity capacity of the economy have been put on 'lay-by' with the surplus for the next two years to be contributed to a Building Australia Fund, a Higher Education Investment Fund, and a Health and Hospitals Fund.

The Government has not delivered on its environment rhetoric.

A new internationally competitive tax regime for the managed funds industry will specifically enhance the MIT sector although the staggered 3 year introduction of the scheme is slow. The owner managed business has seen some recent positive measures repealed but an enhancement to the small business concessions.

The opportunity to introduce a tax free savings account for all investors separate from superannuation, that could have improved Australians chronic savings crises and still reduced demand pressures on the economy, has been foregone.

Overall the tax measures in the Budget are of a housekeeping measure awaiting the tax system review that is to report to the Treasurer by the end of 2009.

**Contents**

# Economic Review

### Economic Growth

- Weaker global growth and higher interest rates will slow Australian growth to 2.75% in 2008-09
- Nominal GDP is forecast to rise to 9.25% in 2008-09
  - Fastest rate for 19 years
  - Caused by underlying inflation and high balance of trade
- Reduces the growth in real Government spending to 1.1%, the lowest for nine years
- Current account deficit reduced to 5% from 5.6%
- Exports expected to grow to 6% of GDP from 3.8% and imports set to remain steady at 9%

### Fiscal Outlook

- Inflation rising to its highest level in 16 years, 4.2%
  - Forecast to reduce to 3.25% by the end of 2009
- Surplus of $21.7 billion, 1.8% of GDP

### Unemployment

- Unemployment expected to increase from 4.2% to 4.75%
  - Expected to strangle wage inflation
- Participation rate to increase to a new high of 65.25%

### Future proofing

- Invest the surpluses of 2007-08 and 2008-09 in the future by expanding the number of 'future' funds
  - $20 billion Building Australia Fund
  - $11 billion Education Investment Fund
  - $10 billion Health and Hospitals Fund
- Provide $1 billion over four years to ensure all year 9-12 students have access to their own computer and provide $5.7 billion over five years to fund a national broadband network

### Other matters

- Improve efficiency of all government departments, cutting costs by 2% (except defence which receives an increase in funding) giving a saving of $1.8 billion over five years
- Provide a boost to the housing market by introducing a $6,000 per house tax credit for corporate investors to build affordable housing and introduce savings accounts for first time home buyers
- Ease living pressures by
  - Instructing the ACCC to enquire into grocery prices
  - Give the ACCC new powers to monitor petrol prices
  - Double funding for financial counselling in high need areas

## Snapshot

### Personal Taxation

- New personal tax rates to apply from 1 July 2008
- A taxpayer will need to earn $121,739 to pay an average rate of 30% in 2008-09 including Medicare levy
- Low income tax offset has increased to $1,200
- Childcare tax rebate changes
- Education tax refund
- Senior Australians will pay no tax on income up to $28,867 for singles and $24,680 for each member of a couple
- Increase to Medicare levy surcharge

### Indirect & Employment Taxes

- FBT loop-holes closed
- GST measures
- Luxury car tax rate changes

### Business Owners Taxation Change

- Family trust changes
- Entrepreneurs' tax offset means tested
- Super contribution clearing house
- Small business concession changes

### Wealth Management Issues

- Employee share schemes
- Capital protected loans

### Corporate

- TOFA stage 3/4 from 1 July 2009
- Debt/equity amendments
- Managed funds: new withholding tax rate for non-residents
- Superannuation clearing house facility
- Depreciation of in-house computer software
- Consolidation changes

# Personal Taxation Proposals

The Government has implemented its election policy to reduce personal income tax in order to enhance workforce participation and ease the financial pressures on families.

Effective from 1 July 2008:

- The 30% threshold will be raised from $30,001 to $34,001
- The 40% threshold will increase from $75,001 to $80,001
- The 45% threshold will increase from $150,001 to $180,001

An average taxpayer earning $50,000 a year will have a tax cut of $1,000 or about $20 per week in 2008-09 compared to the previous year.

This means that with the Medicare levy of 1.5%, an individual taxpayer with a taxable income of $121,739 will be subject to an effective tax rate of 30%

From 1 July 2009:

- The 30% threshold will be raised to $35,001
- The 40% tax rate will be reduced to 38%

From 1 July 2010:

- The 30% threshold will be raised to $37,001
- The 38% rate will be reduced to 37%

**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- 34,000 | 29% |
| 6,001- 34,000 | Nil + 15% of excess over 6,000 | 34,001- 80,000 | 9,860 + 30% of excess over 34,000 |
| 34,001- 80,000 | 4,200 + 30% of excess over 34,000 | 80,001- 180,000 | 23,660 + 40% of excess over 80,000 |
| 80,001- 180,000 | 18,000 + 40% of excess over 80,000 | 180,001 above | 63,660 + 45% of excess over 180,000 |
| 180,001 above | 58,000 + 45% of excess over 180,000 | | |

**Proposed income tax rates: 1 July 2009 – 30 June 2010**

| Resident | | Non-resident | |
|---|---|---|---|
| Taxable income ($) | Tax payable ($) | Taxable income ($) | Tax Payable ($) |
| 0- 6,000 | Nil | 0- 35,000 | 29% |
| 6,001- 35,000 | Nil + 15% of excess over 6,000 | 35,001- 80,000 | 10,150 + 30% of excess over 35,000 |
| 35,001- 80,000 | 4,350 + 30% of excess over 35,000 | 80,001- 180,000 | 23,650 + 38% of excess over 80,000 |
| 80,001- 180,000 | 17,850 + 38% of excess over 80,000 | 180,001 above | 61,650 + 45% of excess over 180,000 |
| 180,001 above | 55,850 + 45% of excess over 180,000 | | |

From 1 July 2008, senior Australians eligible for the senior Australians tax offset will pay no tax on their annual income up to $28,867 for singles and $24,680 for each member of a couple. By 1 July 2010, these thresholds will rise to $30,685 for singles and $26,680 for each member of a couple.

The Government's goal is that by 2013-14 the number of personal income tax rates will be reduced to three (15 per cent, 30 per cent and 40 per cent) and the Low Income Earner Tax Offset (LITO) will be further increased.

LITO also increases, resulting in a higher effective tax-free income threshold as follows:

| Income year | LITO Amount $ | Effective Tax-free income threshold |
|---|---|---|
| 2007-08 | 750 | 11,000 |
| 2008-09 | 1200 | 14,000 |
| 2009-10 | 1350 | 15,000 |
| 2010-11 | 1500 | 16,000 |

The government aims to create an effective tax-free threshold for those eligible for the low-income tax offset of $20,000 by 2012-13.

### Medicare Levy Surcharge changes:

| | Current | From 1 July 2008 |
|---|---|---|
| Single people | $50,000 | $100,000 |
| Couples | $100,000 | $150,000 |

### Increase in Child Care Tax Rebate

The Child Care Tax Rebate (CCTR) will be increased from 30 per cent to 50 per cent, which means that half of a family's total out-of-pocket child care costs will be met every year. The cap on the amount that can be paid each year will also be lifted from the current amount of $4,354 to $7,500 per child.

The CCTR will be paid every quarter, instead of once a year.

However, higher income families currently receiving the minimum rate of Child Care Benefit will no longer receive this benefit after 1 July 2008.

### Education tax refund

From 1 July 2008, families that are eligible to receive Family Tax Benefit Part A will be entitled to a refund of up to half of the cost of their children's education expenses. The maximum refund is $375 per primary school student and $750 per high school student. Whilst education-related computers, internet connections, printers, software and textbooks are eligible for the refund, school fees, uniforms and excursions are not. The offset will be fully refundable in cases where the offset exceeds a taxpayer's tax liability.

### Family Tax Benefit Part B

Eligibility for the Family Tax Benefit Part B will be means tested from 1 July 2008; payable only when the main income earner's adjusted taxable income is below $150,000.

### Baby Bonus

Eligibility for the Baby Bonus will be means tested from 1 January 2009, payable only where a family's adjusted taxable income is under $75,000 in the six months after the birth of a baby (equivalent to an annual income of $150,000).

Furthermore the bonus will increase to $5,000 from 1 July 2008 and will now be paid in 13 fortnightly installments of around $385, rather than a lump sum.

### Means testing of government support expanded

From 1 July 2009, the definition of "income" will be expanded in the following three areas to determine eligibility for government support programs:

- Certain salary sacrificed contributions to superannuation will be included in "income" for income support payments for people below Age Pension age, family assistance, child support, superannuation co-contributions and financial and retirement programs
- The definition of adjusted taxable income will be extended such that all net financial losses are required to be added back to a taxpayer's taxable income, not just rental property losses, which can impact on a taxpayer's Medicare Levy surcharge, higher education loan repayments and child support obligations
- Reportable fringe benefits will be included in "income" for dependency tax offsets, senior Australian tax offset, and pensioner tax offset

# Employment & Indirect Taxes

## FBT

With effect from 7:30pm on 13 May 2008 the Government has announced a reduction in the benefits otherwise available to individuals. Limited transitional provisions apply for arrangements already in place. The changes effect the following tax exemptions:

- Eligible work related items such as laptops
- Jointly held assets
- Meal entertainment consumed on premises

### Exemption for Eligible Work-Related Items

The broad based FBT exemption for laptops and similar items is being restricted. Such items provided by employers will now be required to be used 'primarily for work purposes' for the FBT exemption to apply. The items affected include:

- Laptops or portable computers
- Electronic diaries
- Personal digital assistants or similar items

The limit of one item of each type, unless it is a replacement, will remain unchanged. There are no transitional provisions in place, the rules have immediate effect.

An income tax deduction for deprecation on the above items purchased by employees and subsequently reimbursed by employers will also be denied, preventing the double deduction that was (arguably) previously available.

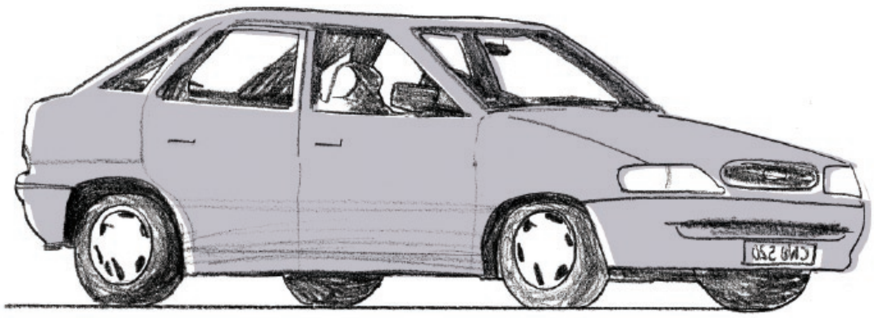
### Jointly Held Assets

Previously, an employer could pay the entire interest amount on a mortgage of a rental property that an employee held jointly with his/her spouse. An income tax advantage arose where the employee was on a higher tax bracket than his/her spouse, by applying the spouse's deduction against his/her income.

FBT will now be payable on the associate's portion of costs relating to a jointly held investment asset and the FBT exemption will only be available for the employee's portion, effectively removing this benefit. Transitional provisions for existing salary sacrifice arrangements will apply.

### Meal Entertainment

There have been a number of salary sacrifice arrangements in place to enable employees to obtain a tax advantage by purchasing meals with no FBT or income tax applicable. Meals consumed on premises by an employee under a salary sacrifice arrangement will now be subject to FBT. Transitional provisions apply for existing arrangements where the employee currently has credit on existing 'meal cards'. Subsidised canteens will remain exempt from FBT where it is not part of a salary sacrifice arrangement.



**Luxury Car Tax**

- Rate has increased from 25% to 33% with effect from 1 July 2008
- Threshold increases from $57,123 to $57,180
- Represents an increase of $2,000 - $2,600 on popular luxury vehicles

## GST

### Budget changes

- Global telecom roaming services provided to visitors to Australia will be GST-free
- Margin Scheme:
  - Anti-avoidance measures are to be introduced to prevent manipulation of the scheme
  - Where the margin scheme is used after a GST-free or non-taxable supply, GST will be due on the value added by the supplier
- A GST package for charities that was announced by the previous Government will not be introduced. This included:
  - The associates rules for branches were to be disapplied
  - New costing methods for GST-free supplies were to be introduced
  - Supplies for no consideration were to be treated as GST-free

### Other recent changes

- Alteration to the GIC charge where the 'error' is 'revenue neutral'
  - This means that the ATO will no longer charge GIC in a wash transaction where there is no loss of GST. For example, if an entity claims an input tax credit that should have been claimed by an associated entity. Previously GIC would be partially remitted
- Change in the regulations on 1 July 2008 to ensure that claims for overpaid GST extend back no more than 4 years and provide that any GST refund is repaid to the customer
  - An anomaly in the legislation permitted claims to be made for overpaid tax for more than four years in certain specific circumstances, such as where GST was accounted for, in error, on a transaction that was not a supply for GST

# Business Owners

## Family Trusts

From 1 July 2008, the definition of family members will be narrowed for the purposes of the family trust election requirements of the trust loss provisions. The lineal descendants of the nephews and nieces of the test individual and the test individual's spouse will no longer form part of the family group.

Under changes introduced by the previous government (that came into effect from the 2007-08 year), the lineal descendants of such nieces and nephews were included in the family group. This was a welcome change because many family trusts were used by siblings to invest or carry on their businesses together. Being able to include the lineal descendants of nephews and nieces meant that neither of sibling's families was disadvantaged.

Prior to the 2007-08 year the only way to deal with this issue was to nominate one of their parents as the test individual which would have limited the life of the trust because the family group stopped at the test individual's grandchildren.

However this year's Budget does seem to have considered this problem, despite removing the lineal descendants of nephews and nieces. For new family trust elections, the nomination of the parent as a test individual would now seem to include all the lineal descendants of their children and grandchildren.

Where one of the siblings has already been nominated as the test individual there appears to be no relief. To compound this problem the Government has retrospectively removed the one-off opportunity to change the test individual that was previously available from the 2007-08 income year.

Fortunately, the Government has maintained some of the relief provisions that the previous government introduced including:

- concessions in the definition of family group so as to take into account death or divorce
- allowing the family trust elections to be revoked where the original elections have never been required

The two siblings may be able to take advantage of these concessions.

## Entrepreneurs' tax offset

From 1 July 2008, eligibility for the entrepreneurs' tax offset will be subject to an adjusted taxable income test of $75,000 for singles or $120,000 for families. This test is in addition to the $75,000 annual turnover test.

## Super contribution clearing house

A Government sponsored superannuation contribution clearing house will commence in the 2009-10 in order to assist businesses in managing super contributions under choice of super fund regime. The clearing house will be free for businesses employing less than 20 staff, while larger businesses will incur a nominal fee.


## Small business entity rules

- Access to the small business CGT concessions via the small business entity rules (ie $2m turnover) will be extended, from 1 July 2007, to cover associated entities
- The extension applies to entities that hold assets which are used by a small business entity, e.g. will cover a trust that owns property which is rented to an associated company for use in its business.

# Wealth Management

## Employee share schemes

The Government has announced measures to ensure that income from employee share schemes is correctly reported by taxpayers.

**Current position:**

- A taxpayer wishing to be assessed upfront on certain ‘qualifying’ shares and options must make an election
- This election must be made before lodgement of the relevant tax return (or within such further time that the ATO allows)
- The written election is not required to be lodged with the ATO

This enabled some taxpayers to employ a “wait and see” approach in respect of the taxation of their shares or options, with the ability to go back and amend the relevant income tax return to ensure the optimal tax treatment.

**New measures from 1 July 2008**

- Where a taxpayer wishes to make a choice to be assessed under the taxed-upfront concession, the way the tax return is prepared will be sufficient evidence of making this choice
- If an amount is not included in the income tax return in the year in which the shares or options are acquired, the taxpayer will be taken to have chosen to be taxed under the tax-deferred option
- The Commissioner retains the power to allow an extension of time to make the election

Practically speaking this eliminates the “wait and see” mentality and forces a decision to be made from the outset which must be adhered to as it is likely that the Commissioner’s discretion will be closely administered.

In addition, a further change has been announced in relation to certain employee share schemes which involve employee share trusts. Under the current legislation, double taxation arises on the transfer of shares from the trust to the employee, as the capital gains made by the trustee whilst the shares are held in trust are also assessable to the employee.

The new measure will remove this double taxation and is welcomed. This change will apply to CGT events that occur from 13 May 2008.

## Capital protected loans

The benchmark interest rate for deductibility of interest on capital protected loans has been reduced for arrangements entered into from 7.30pm on 13 May 2008. The current measures will continue to apply to existing products for a period of 5 years or the life of the product (whichever is shorter).

The new rate is capped at the RBA’s variable rate for standard housing loans (current indicative rate is 9.35% p.a.). Interest in excess of this rate will be treated as the cost of capital protection and will not be deductible being on capital account.

# Corporate

### Taxation of Financial Arrangements (TOFA)

The Government has committed itself to Stage 3 and Stage 4 of the TOFA regime. The TOFA legislation was drafted by the previous government and lapsed when the 2007 Federal election was called.

Stages 3 and 4 will introduce new tax rules for accruals/realisation, fair value, retranslation, reliance on financial reports and hedging. These will come into effect from 1 July 2009. Further, the elective commencement date of 1 July 2008 will not apply.

### Debt / equity and foreign currency amendments

The Government will proceed with measures that clarify the tax treatment of certain Upper Tier 2 and similar capital instruments. These measures are designed to facilitate debt tax treatment of such capital instruments issued by banks.

Amendments to the foreign currency provisions to extend the scope of a number of compliance cost saving measures and to make technical amendments to ensure the provisions operate as intended will proceed. The amendments will have effect from 1 July 2003.

### Managed Funds

Withholding Tax (WHT) on Australian source net income distributions (other than dividends, interest and royalties) made by an Australian Managed Investment Trust (MIT) to foreign residents has been reduced to a final WHT of 7.5%. Distributions of dividends, interest and royalties continue to be covered under the existing final WHT regime.

The new WHT measures will be restricted to countries with which Australia has Exchange of Information (EOI) agreements and are specified in regulations. The measures are proposed to be effective from 1 July 2008, and will be phased in over 3 years as follows:

- 22.5% non-final WHT in the 1st income year (intended 2008-09)
- 15% final WHT in 2nd income year (intended 2009-10)
- 7.5% final WHT in later income years (intended 2010-11 and later income years)

As an interim measure, for the first income year, investors resident in EOI jurisdictions can claim a deduction for expenses relating to their fund distributions.

Foreign investors of other jurisdictions will be subject to 30% final WHT.

This measure should make MIT's more attractive to non-resident investors seeking an internationally competitive after-tax return.

### Depreciation of in-house computer software

The period of expenditures on in-house computer software will be increased from 2.5 years to 4 years on a straight line basis for expenditures incurred after 7.30pm on 13 May 2008 (reducing the depreciation rate from 40% to 25%).

### Scrip for Scrip

The Government will modify the CGT scrip for scrip roll-over provisions to ensure that, for corporate restructures, the acquiring entity's cost base of shares in the target entity reflects the tax costs of the target's net assets. This cost base will also be used in determining the value of the target's assets in consolidation if they subsequently join the acquiring entity's consolidated group.

Under the current provisions, the acquiring entity obtains a market value cost base for the shares it acquires in the target entity. This can result in significant unintended tax benefits arising if, the target entity subsequently joins the acquiring entity's consolidated group. The measure seeks to prevent companies from obtaining unintended tax benefits if they restructure.

### Other

The consolidation regime is being amended in a number of ways that in the main affect the determination of the cost bases of assets within a consolidated group. CGT Event L7 is being repealed.

In relation to the carrying forward of company losses, the same business test is amended to correct technical defects, including ensuring that the single entity rule under consolidation does not affect the "same business" of a loss company that enters a group.

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