Grant Thornton

2011-12 Federal Budget Summary

11 May 2011

Positioning Australia to capitalise on the long-term promise of the "Asia Century" and the concomitant mining investment boom underpins the 2011-12 Federal Budget released on 10 May 2011. But the Treasurer, the Hon. Wayne Swan, is frustrated by a "patchwork economy" and the impact of natural disasters.

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Tax revenues have collapsed in the current year giving rise to a deficit of nearly $50 billion but the position is set to improve somewhat with a deficit of $22 billion forecast for 2011-12.

Yet the Government is confident that good times are ahead and they predict a minor surplus for 2012-13. This indicates a strong faith that continued significant mining investment, strong commodity prices and sustained strength in China will override current economic uncertainty around the globe. There is a hint of "magic pudding" in this but we hope that the Government is right.

With the spectre of virtual full employment again looming, the Government is focusing on building Australia's economic capacity so that we can cope with increased demand. A number of inducements for individuals to work are apparent and investment in skills development and training has been boosted as has the working migrant intake. It may become tougher to obtain welfare without exhausting work opportunities. Small business is to have incentive to buy plant and equipment by virtue of an up front incentive for new vehicles from 1 July 2012.

Some infrastructure measures were announced including some needed tax reform, but this aspect appears too narrowly targeted and represents a lost opportunity.

Aside from expected investment in education and health care, including regional initiatives, a significant $2.2 billion will be invested into mental health reform over five years.

The charities and not-for-profit sector is up for major overhaul. Significantly, an Australian Charities and Not-for-Profit Commission is to be established to oversee the sector and cut "red tape". The taking of regulation of this largely tax-free sector out of the hands of the tax collector is welcome, as should be the move to replace the 400-year-old notion of charity with a statutory definition, although reaching a conclusion on this will no doubt distract the efforts of the sector.

What is not welcome is the proposal to tax the "unrelated businesses" of charities and we expect much debate to ensue as a result.

While our medium term prospects hold promise, amid immediate uncertainty, we expect to see Government tax collection activities going into overdrive. We have seen significant increases in ATO audit and investigations in recent times and this can only further increase. This is the time to assess your tax risks and get your house in order.

Broadly, the future looks bright. Like the Government, it behoves us all to position ourselves to capitalise on opportunities presented.

Increasing productivity

Meeting skill shortages

In addition to the rhetoric on getting unemployed Australians into the workforce, this year's Budget strongly focused on ensuring that skilled workers are available for key industries. Announcements included:

- An additional 16,300 visa places under the total migration program taking the total number of visas to 185,000. This includes a special increase of 6,000 visas under the Regional Sponsored Migration Scheme, taking the Scheme to 16,000 visas per year
- The highest priority is to be given to visas processed under the Regional Sponsored Migration Scheme to support regional growth and rebuilding
- There is a stated aim to reduce the processing time for 457 visas from four weeks to two weeks through the construction of a new processing facility in Brisbane
- The introduction of Regional Migration Agreements (RMAs) and Enterprise Migration Agreements (EMAs)
- The cost of applying for 457 visas will increase by 15% from 1 July 2011

Small business and other measures

Small business motor vehicle tax write-off

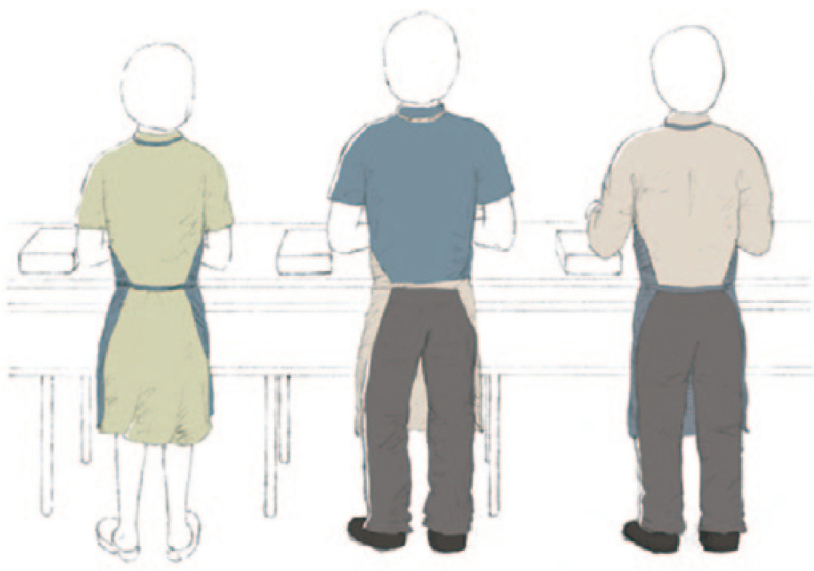
Small businesses currently have access to the utilisation of a general small business depreciation pool for assets purchased for more than $5,000, which is depreciated at 15% in the first year and 30% in later years. The Government has announced that Australian small businesses will now receive an instant tax write-off of the first $5,000 of any motor vehicle purchased from 2012-13. The remainder of the purchase value can be transferred into the general small business depreciation pool. This measure is introduced to replace the Entrepreneurs Tax Offset which will be abolished from the 2012-13 year.

The Treasurer said this new write-off was in addition to the Government's proposed tax reforms for small businesses to be introduced in 2012-13.

Personal Taxation

Dependant Spouse tax offset

As part of the Government's Budget announcement to encourage more Australians into the workforce, the Dependant Spouse Tax Offset (DSTO) will be phased out for a dependent spouse under 40 years old, from 1 July 2011.



Superannuation

Excess contributions

With contribution caps extremely easy to exceed inadvertently, the Government is to allow each taxpayer a one-off option to have excess contributions refunded and taxed at their normal marginal tax rate. However, this only applies for the person's first breach, the excess must be less than $10,000 and only applies to contributions made after 1 July 2011.

We expect this to face tough industry opposition. While it may provide a small saving for some taxpayers, it may cost more for super funds to administer than it will save in tax. No detail has been provided at this stage, including no comment on:

- whether adjustment is to be made for the initial 15% contribution tax paid by the super fund; eg is it rebateable to the individual or will the super fund obtain its own credit or claim a deduction for the contribution refunded?
- which year the excess contribution amount will be assessable to the individual and the time frames in which the system will operate

	Currently	Proposal – as low as:				
Marginal tax rate		0.0%	15.0%	31.5%	38.5%	46.5%
Contribution tax (15%)	1,500	–	–	–	–	–
Excess contribution tax (31.5%)	3,150	–	–	–	–	–
Tax at marginal rate	n/a	–	1,500	3,150	3,850	4,650
Total tax payable	4,650	–	1,500	3,150	3,850	4,650
Possible tax saving		4,650	3,150	1,500	800	–

Pension reduction

Minimum pensions will again be reduced for the 2011-12 year, but only by 25% (rather than 50% currently applicable). Full minimum amounts will need to be withdrawn from the 2012-13 year onwards.

Age	2009, 2010 & 2011 years	2012 year (proposed)	2013 year (revert to normal levels)
Under 65	2%	3%	4%
65 to 74	2.5%	3.75%	5%
75 to 79	3%	4.5%	6%
80 to 84	3.5%	5.25%	7%
85 to 89	4.5%	6.75%	9%
90 to 94	5.5%	8.25%	11%
95 or more	7%	10.5%	14%

Increase in supervisory levy

The supervisory levy will be increased by $30 (to $180 p.a.) to help provide additional funding to the ATO for the regulation of Self Managed Superannuation Funds (SMSFs).

Trading stock exemption

Super Funds will be prevented from treating some investments as trading stock, stopping a small number of funds from claiming a deduction for investment losses against other income (rather than carrying them forward as capital losses).

The Budget also confirmed prior super announcements including a $50,000 concessional cap for those over 50 years of age with super less than $500,000; co-contribution thresholds will not be indexed; and minor reporting measures to assist with identification of lost super.

Charities and not-for-profits

As had been hinted in advance, the not-for-profit sector has attracted a renewed focus under Government initiatives designed to ensure that income tax concessions are only enjoyed by those entities which are actively putting funds into philanthropic activities.

The reforms target those charitable organisations which carry out commercial activities and hold the proceeds in the commercial undertaking, rather than applying them straight away for charitable aims. Starting with new commercial undertakings commenced after 10 May 2011, income tax will be payable on retained profits and any FBT and GST concessions will not be accessible. Deductible gift recipient status will also not be available in relation to commercial activities.

The Government has announced that commercial activities which further the charitable aims and unrelated commercial activities described as "small-scale and low-risk" will not be affected by the reforms. This follows on from the High Court decision in the matter of *Word Investments v FC of T* in 2008 where it was judged that conducting a profit making activity would not of itself prevent an entity from achieving charitable status providing the proceeds were specifically required to go towards the specified charitable aims.

Whilst the initial announcement tackles only new commercial activities, the Government has announced their intention to phase out the concessions following consultation on an appropriate transitional process.

The other key change, hailed as an initiative to cut bureaucracy and red tape across the sector, is the announcement of $53.6million of funding over four years to establish a new, independent agency, the Australian Charities and Not-for-Profits Commission.

The Commission will be responsible for determining charitable, PBI and other not-for-profit status for entities which will be used for all Commonwealth purposes. The ATO will commence the process of passing over this responsibility for tax purposes from 1 July 2011 when the job of determining charitable status will be structurally separated from the day-to-day administration of resultant concessions.

The job of determining charitable status is to be further aided by the introduction of a statutory definition of "charity" to be used across Australia. This will be implemented following a consultation process across the states and territories.

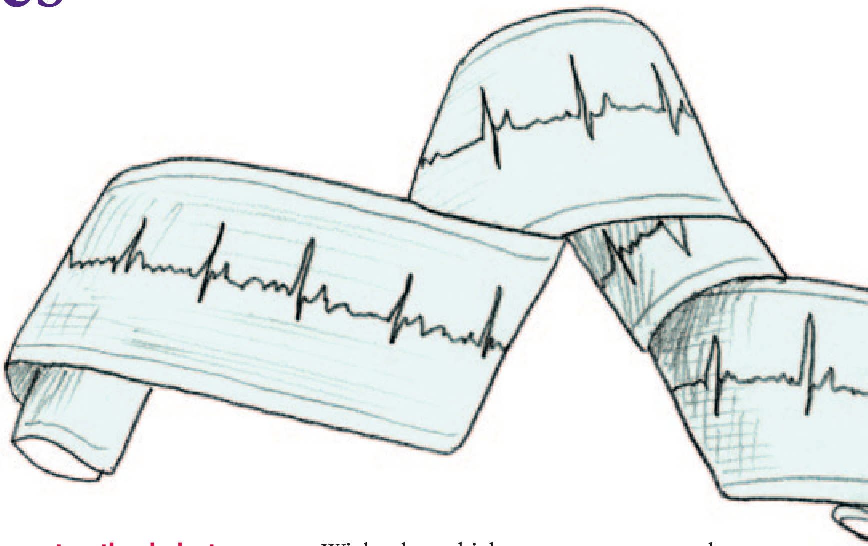
The Government has estimated that the establishment of the new Commission will increase tax revenue by $41.0 million over four years as a result of additional compliance activity, so not-for-profits can expect that scrutiny of their affairs will be stepped up in the short term.

This scrutiny will certainly not be diminished by the announcement that $43.3 million over four years is being given to the ATO to improve their monitoring of government grants and payments with the target of finding an additional $137.8 million in receipts over four years.

One other technical change has been put in place to allow museums and art galleries to import exhibits without being subject to the luxury car tax legislation.

By and large this Budget heralds a period of change for the whole charitable and not-for profit sector. Some aid organisations are already announcing cautious optimism that if the level of red tape is actually cut as a result, the process may be worthwhile.

Integrity measures



Personal tax measures

Low income tax offset and minors

Income splitting opportunities between adults and children are to be limited by removing access to the Low Income Tax Offset for minors on unearned income. This is particularly focused on those who are making distributions to children from discretionary trusts and is estimated to raise $740 million over the first three years. Income from work will be unaffected as will unearned income of orphans or disabled minors. The table illustrates a significant individual impact:

Type of Income	Maximum Tax-free Unearned Income for Minors		
	2011	2012	Reduction
Franked income	7,000	534	92%
Other income	3,333	416	88%

Disallowing deductions against government assistance payments

From 1 July 2011, the Government will prevent deductions being claimed against all government assistance payments in response to the well publicised *Anstis* High Court decision.

The ATO's treatment announced on 17 December 2010 will stand for the years 2006-07 to 2009-10.

Students will still be able to claim deductions for self-education expenses incurred for the 2010-11 income year.

Building and construction industry requirements for reporting taxable payments

Certain businesses will be required to report annually on payments made to contractors in the building and construction industry from 1 July 2012. The information to be reported is already required to be collected under existing arrangements, so should not impose any additional administrative cost burden to the reporter. The ATO is to receive additional funding for such things as data matching, reviewing contractors' tax liabilities and undertaking targeted audit activity.

GST – Restoring the policy intent

The Government confirmed its commitment to clarify the law in line with their view of the policy intent in areas such as:

- treatment of new residential premises
- treatment of property in possession of a mortgagee
- certain supplies to health insurers

Minor changes were announced in response to a Board of Taxation report on a range of GST matters.

Project Wickenby and other ATO enforcement activity

Project Wickenby

The showcase of ATO activity continues to be the much publicised Project Wickenby, which targets taxpayers who have allegedly failed to disclose foreign income. The ATO has issued over $1bn in tax assessments so far and there are another 500 or so taxpayers in their sight. Australia, like many OECD countries, is embracing new information exchange agreements which are intended to allow greater access to information that will halt cross border evasion. The Budget announced a curtailment of funding for the Australian Crime Commission's involvement in new litigation, but this will not stop continued ATO activities.

Phoenix companies

The Government has shown its intention to clamp down on promoters of "phoenix" companies – being those that are liquidated with accumulated business debts, while the controlling owners continue business in a new entity. From 1 July 2011, the director penalty regime will be extended to superannuation guarantee payments, making directors liable for non-payment. In addition the ATO will have stronger powers for debt recovery and to deny tax credits for associates.

Other activities

Taxpayer fraud is targeted with $100m set aside over four years for improved data matching and fraud detection. SME (turnover up to $250m) and high net worth risk reviews and audits will continue.

FBT and vehicles

A flat statutory rate of 20% is to replace the previously scaled rates used in calculating the taxable value of car fringe benefits under the statutory formula method. This is to apply to new vehicle contracts entered into after Budget night and is to phase in over four years as follows:

Distance travelled during the FBT year (1 April – 31 March)	Statutory rate (multiplied by the cost of the car to determine a person's car fringe benefit)				
	Existing contracts	New contracts entered into after 7:30pm (AEST on 10 May 2011)			
		From 10 May 2011	From 1 April 2012	From 1 April 2013	From 1 April 2014
0-15,000km	0.26	**0.20**	0.20	0.20	0.20
15,000-25,000km	0.20	**0.20**	0.20	0.20	0.20
25,000-40,000km	0.11	**0.14**	**0.17**	**0.20**	0.20
More than 40,000km	0.07	**0.10**	**0.13**	**0.17**	**0.20**

The reasoning behind this change is that the previous rates rewarded higher levels of travel and were thus incompatible with other government policies.

The change will simplify the FBT process for some cars, create some additional costs for some organisations, and open up tax saving opportunities for some employees.

We don't have confirmation yet on what a "new vehicle contract" means.

Is this just new car leases and acquisitions or would it include a new salary sacrifice agreement? However, the impact of the changes and what organisations should do to minimize the costs and maximize the opportunities from this change include the following:

Where cars are provided at the organisation's cost and employees are travelling more than 25,000kms pa

Consider having employees complete log books, where this is not done already, so that the log book method of valuing the car benefits can be adopted where this results in less FBT than the statutory formula method.

Where cars are provided at the organisation's cost and employees are travelling less than 25,000kms pa

There will either be no impact of the change (travel between 15,000 and 25,000 kms pa) or the FBT will be reduced (less than 15,000 kms travel pa).

Where employees salary package cars and travel more than 25,000kms pa

Any tax savings will be reduced for these employees and potentially eliminated, but only in relation to "new vehicle contracts" entered into. Future salary packages will need to either include the increased amount of FBT or include higher after-tax contributions to ensure no FBT arises.

Where employees travel less than 15,000 kms pa and have not salary packaged in the past due to there being no significant tax savings

It may be that significant tax savings can now be achieved from packaging cars in this situation. Employers who do not already offer this benefit to staff may wish to consider doing so.

Other notable measures

Personal tax rates

The Government did not make any changes to personal tax rates for residents and non-residents for the 2011-12 year. However the flood levy will apply from 1 July 2011 to both resident and non-resident individuals who have taxable income exceeding $50,000.

Individuals are exempt from the levy if they were affected by a natural disaster during 2010-11 and received an Australian Government Disaster Recovery Payment.

HECS/HELP – reduction in discounts

From 1 January 2012, the discounts applicable to payments made under the Higher Education Contribution Scheme (HECS) and Higher Education Loan Program (HELP) will reduce. Previously, under HECS students had the offer of a 20% discount if electing to pay up front. Under the Budget the discount is proposed to reduce to 10%.

Voluntary repayments of $500 or more were previously eligible for a 10% bonus. In effect, a $500 voluntary payment would reduce the HECS/HELP debt by $550. Under the 2011-12 Budget, it is proposed that voluntary payments of $500 or more will now only attract a 5% bonus. This means that a $500 payment will reduce the outstanding HECS/HELP debt by $525.

Reforms impacting the primary production industry

- Farm Management Deposits (FMD): broadening of “exceptional circumstances” to be eligible for tax concessions and allowing use of multiple authorised deposit-taking institutions.
- Sustainable Rural Water Use and Infrastructure Program: removing taxation impediments for farmers that utilise the scheme.

Capital Gains Tax

The Government has announced a number a changes to the Capital Gains Tax (CGT) provisions notably:

1. Further integrity measures for the scrip for scrip roll-over and the small business concessions
2. Exemption for incentives related to renewable resource assets (e.g. photovoltaic solar cells or solar hot water systems) or for preserving environmental benefits
3. Providing the Commissioner with the discretion to extend the two-year ownership period in which the trustee of a deceased estate or beneficiary of such an estate must dispose of their interest in the deceased’s dwelling to access a full capital gains tax main residence exemption (or a more generous partial exemption)

Other measures include:

Securities lending arrangements – extending the scope to address insolvency issues

The Government has announced a backdated change to certain securities lending arrangements which provides an administrative benefit as a result of issues arising from the Global Financial Crisis. Such changes, if enacted, will be effective from 1 July 2008.

Reducing tax uncertainty for infrastructure projects

A key Government announcement is to provide certainty to developers and subsequent acquirers of infrastructure projects of national significance including to index tax losses at the government bond rate and exclude such losses from the continuity of ownership tests. This is an important recommendation of the report by Dr Ken Henry on Australia’s Future Tax System.

Investment Manager Regime

As well as announcing a review of the Investment Manager Regime, the Government has announced that it will extend for a further year a temporary measure announced last year to not seek to tax certain portfolio investments of foreign fund managers. Further, the Government will also extend the relief to foreign fund managers that are currently only taxed in Australia because they have a permanent establishment here.

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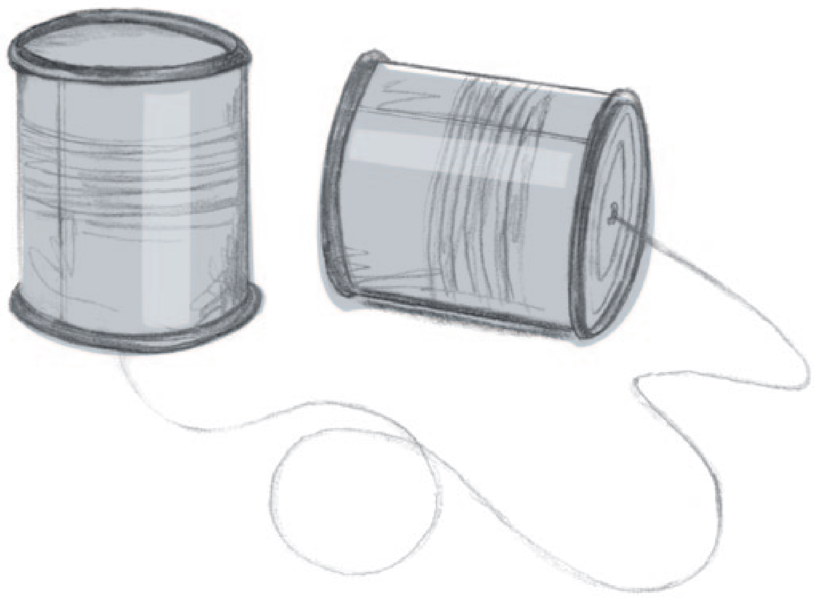

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