

Greenwoods & Freehills

Tax Brief

12 May 2009

Federal Budget 2009-10

Introduction

Extensive and apparently well-sourced leaks over the last 2 weeks drip-fed many details about this year's Budget to an eager media and public. Those leaks, however, tended to emphasise personal tax and social security issues – whether the legislated personal tax cuts would be scrapped, means-testing the family tax benefit, reducing the concessions for contributions to superannuation funds, the survival of the rebate for private health insurance premiums, the survival of the “baby bonus,” increasing certain pensions and the introduction of paid maternity leave.

Speculation about the business tax measures that the Budget would announce was also supported by a few judicious leaks. Further, the Government's ability to announce major changes was somewhat constrained by the reviews it has already set up to inquire into tax issues and have yet to report – the Henry review into Australia's Future Tax System, the Harmer review of pensions and retirement income policy, the Board of Taxation's completed reviews of share buy-backs and the anti-deferral regimes and the Board of Taxation's current review of the taxation of managed investment trusts, for example. And of course, the Government adopted the time-honoured tradition of re-announcing a number of measures that had already been proposed. Even so, tonight's Budget still held a few surprises for business taxpayers.

1. Personal Tax

1.1 Personal tax rates

The pre-Budget speculation that the Government would tinker with the tax reductions scheduled to commence on 1 July proved to be unfounded. The personal tax rates will be (movements are marked in bold):

Current		From 1 July 2009		From 1 July 2010	
Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate
0 – 6,000	0	0 – 6,000	0	0 – 6,000	0
6,001 – 34,000	15	6,001 – 35,000	15	6,001 – 37,000	15
34,001 – 80,000	30	35,001 – 80,000	30	37,001 – 80,000	30
80,001 – 180,000	40	80,001 – 180,000	38	80,001 – 180,000	37
180,001+	45	180,001+	45	180,001+	45

The Government did, however, increase the threshold at which taxpayers commence paying the Medicare levy to \$17,794 for individuals and \$30,025 for individuals in families. The increment to the threshold for each dependent child will also increase to \$2,757. These changes are to be back-dated – that is, they will apply to the 2008-09 income year.

1.2 Employee share plans

Measures announced in the Budget will eliminate the effectiveness of most employee share and option plans, including performance rights plans. The detrimental effects of the measures on employee share-based remuneration probably cannot be over-stated.

First, the “tax deferral” incentive measure will be abolished. Instead, all employees will be taxed in the year of acquisition or allotment on the value of any shares and options issued or allotted to them. Apparently, tax will be imposed regardless of any vesting conditions or sale restrictions. Employees may be entitled to the current \$1,000 exemption, although the terms of this exemption will be significantly restricted. The \$1,000 exemption will be available only to employees with less than \$60,000 taxable income.

These announcements will apply to shares and options acquired after 7.30pm on 12 May 2009.

The Budget Papers are short on detail and leave a number of important questions unanswered. For example:

- existing shares and options will not be affected, but it is not clear what treatment applies to currently outstanding offers;

- it is not clear whether the taxable value of shares and options will recognise the impact of any vesting or forfeiture conditions or sale restrictions. (The only indication in the Treasurer's Press Release is to the contrary); and
- it is not clear what will happen if shares do not vest. Will tax paid earlier be refunded? Refunds are currently available for tax that employees elect to pay on acquisition of "qualifying" options that subsequently lapse.

This announcement will probably eliminate broadly-based share plans in Australia in the future. It increases the disparity between the Australian treatment of share and option plans and the regimes operating in other countries which, as a general rule, do not tax employee equity until it vests. It will also mean that employees will more likely expect remuneration in cash rather than shares or options, just when economic conditions are demanding that employers retain cash for working capital. Companies will need to review their remuneration strategies to see whether they can continue to offer employer equity as a salary component.

One potential solution, which is not immediately affected by what has been announced, is an employee share loan plan. Shares are purchased at full market value using a limited recourse, interest free, employer loan. In nominal terms the shares are not acquired at a discount and therefore do not rely on tax deferral. These plans have their own tax and commercial limitations, however, and it remains to be seen whether they will also be targeted by the legislation when it comes.

1.3 Foreign earnings

Under current law, foreign earnings derived by an Australian resident taxpayer from at least 91 days of continuous employment in a foreign country are generally exempt from Australian tax. From 1 July 2009 this exemption will be limited to income earned as an aid worker, a charitable worker, under certain types of government employment or on projects that are in the national interest.

The Budget papers state that "the original intent of this measure was to relieve double taxation, however, in practice little foreign tax may actually be paid on the foreign income concerned." From 1 July 2009 this foreign employment income will generally become taxable. However, those taxpayers will be entitled to a foreign income tax offset for foreign tax paid on the foreign employment income to avoid double taxation. This will alleviate double tax but result in an increase in compliance costs. Those working in low-tax jurisdictions for an extended period may now be more inclined to claim that they are no longer residents of Australia for tax purposes.

1.4 Fringe Benefits Tax

Changes are to be made to the FBT law to prevent an FBT liability from arising where an employee enters into a salary sacrifice arrangement under which forgone salary is paid to a deductible gift recipient of the employee's

choosing. This is a re-announcement of changes outlined in the Assistant Treasurer's Press Release of 24 February.

2. Business Tax

The Budget contained a longish list of discrete business tax measures.

2.1 Share buy-backs

Introduction. The Budget contains the long-awaited Government response to the Board of Taxation's project on share buy-backs which began in October 2006. The Board's report was sent to the Government in June 2008 and the measures will take effect from the date of Royal Assent of the amending legislation. In the meantime, the Government will engage in further consultations on the design of the announced measures. Details of the consultation process on the design of the legislation will be released by 31 May 2009.

The Board of Taxation's recommendations which have been accepted by the Government (with one exception), simply legislate the current tax treatment of off-market share buy-backs applied by the Australian Taxation Office on an administrative basis. Hence, this may explain why these measures are labelled as "reducing compliance costs" for business.

The announcement proposes legislating 6 key elements for share buy-backs.

Administrative cap on the level of discount. For off-market share buy-backs conducted by listed companies, the administrative cap on the level of discount (14%) at which shares may be bought back that the ATO currently administers will be removed. The implication is that listed companies will now be allowed to set the buy-back price at any level that is commercially acceptable. While unlisted companies are precluded from this concession, this may be largely irrelevant as they continue to be subject to the deemed market value rules (see below).

Automatic franking debit. A self-executing provision will be enacted to automatically debit the franking account of a company that undertakes an off-market share buy-back, to reflect the perceived "streaming" of franking credit benefits from non-resident shareholders that arguably arise under such a buy-back. This will apply to both listed and unlisted companies.

For listed companies conducting a tender style off-market share buy-back, this franking debit is probably the trade-off for the decision to remove the capital benefit streaming rules and the dividend streaming rules that create practical difficulties in this area. This trade-off is not extended to off-market buy-backs conducted by unlisted companies.

Disallowance of notional losses. Losses realised by shareholders that participate in off-market share buy-backs conducted by listed companies will be adjusted in some cases. That is, rules that currently affect only corporate shareholders will be extended to other types of taxpayer. As a consequence, another rule which adjusts the buy-back price to a fictional

market value for CGT purposes is now considered unnecessary and will not apply to off-market share buy-backs conducted by listed companies.

Conversely, losses of all shareholders (including corporate shareholders) that participate in off-market share buy-backs conducted by unlisted companies will be allowed. Accordingly, the deemed market value uplift rule will continue to apply in this case.

Preferred methodology for capital/dividend split. The default methodology for determining the division of the buy-back price between the capital and dividend components will be the average capital per share. The Commissioner will be provided with a discretion to permit an alternative methodology in appropriate circumstances.

Extension of time for giving distribution statements. Listed companies will be provided with extra time to provide distribution statements to participating shareholders.

Relocation of the rules. The rules governing buy-backs, including the amending provisions, will be moved to the *Income Tax Assessment Act 1997*.

2.2 Managed investment trusts

The Budget announced two important changes for managed investment trusts (“MITs”).

Elective CGT treatment. In a much-anticipated announcement, the Government will implement an interim recommendation by the Board of Taxation that MITs be entitled to elect capital gains tax treatment for their assets. The ATO set the cat amongst the pigeons last year with their review of the capital-revenue treatment adopted by funds. This initiative was ultimately deferred and the issue was instead specifically included in the terms of reference of the Board of Taxation’s current review of MITs. The Assistant Treasurer asked the Board to provide its recommendations on this issue ahead of the rest of its report. The Budget announcement will generally entitle MITs to validate existing practice.

The terms of the Budget announcement provide for elective CGT treatment for MIT assets for the first year that commences after the 2008-09 year (i.e. the current year for most trusts). This is, in part, an integrity rule to prevent any attempt to realise current losses, assert that these are on revenue account, and subsequently elect CGT treatment. It is not clear what the position will be for any trusts whose 2008-09 year has already finished (i.e. early balancers). The election will be irrevocable.

The election will apply to “eligible assets” – broadly, shares, units and real property held by MITs. It is expected that eligible assets will not equate with the Division 6C list but rather follow the form of the superannuation deemed CGT rule. If so, CGT treatment is unlikely to apply to fixed interest securities and forex gains and losses. It is unclear what definition or test of MIT will be used although there are several possibilities, the most likely being the definition currently used in the MIT withholding regime. The impact will be that gains distributed will be treated as capital gains in the hands of resident

investors and potentially subject to exemption for non-residents (except if the assets are taxable Australian property). Further, the proposal will apply to MITs as well as to unit trusts that satisfy the eligible investment rules in Division 6C and are 100% owned and controlled by MITs. Trusts which are subject to corporate taxation will be precluded from making the election. A Treasury consultation document will be released to address implementation issues.

Of course, not electing into the regime may not automatically mean that revenue treatment will apply. It is yet to be seen if the ordinary tests of capital-revenue will still play a role for this purpose.

Trusts will need to consider carefully whether it is beneficial for them to make the election. The reason is that some trusts will hold revenue assets (e.g. interests in external funds or shares deliberately held as a trading portfolio) that currently have an unrealised loss position. Presumably, the making of the election would result in a capital loss being realised, which is likely to be of little benefit to the trust in the current environment.

Trust roll-over. In October 2008, the Government announced the removal of the CGT exemption that had existed where assets were transferred between trusts with identical terms. After the announcement, Treasury released a Discussion Paper in response to which the Government received a number of submissions from industry recommending some form of modification to this blanket announcement.

In its place the Government has now announced a more limited form of CGT roll-over for assets transferred between trusts that have the same beneficiaries with the same entitlements. Critically, the roll-over will only be available for so-called "fixed trusts" where there are no material discretionary elements.

The new measure could be of significance in relation to restructures of larger, widely held trusts, especially given the ATO's historical approach in relation to what constitutes a fixed trust. Integrity rules will accompany the new measures, which are expected to include a requirement for beneficiaries to adjust the CGT attributes of their interests in the trusts involved in the transfer.

The measure will apply retrospectively from 1 November 2008.

2.3 Changes to depreciation – technical amendments

The Government has announced various technical amendments to the depreciation regime. The stated objective of the amendments is to correct minor deficiencies and improve certainty for taxpayers. Most of the amendments will commence on 1 July 2009, but some will apply retrospectively from 1 July 2001 (when the current depreciation rules came into effect). Two of the more significant amendments (which will apply from 1 July 2009) include:

- correcting problems with the current text, where the "economic owner" and therefore, the holder of a depreciating asset may not be correctly identified for tax purposes. In particular, the amendments will ensure

that, in cases where a lease arrangement has a combined put and call option and it is certain that at least one of them will be exercised, the lessee will be regarded as the “economic owner” (and therefore, the holder) of the asset for depreciation purposes; and

- clarifying and improving the interaction between the depreciation rules and the rules which deal with hire-purchase arrangements. In particular, the amendments propose to make it clear who is the notional seller in a hire purchase arrangement and clarify the termination value for a notional seller and the cost for a notional buyer.

The other amendments (of which there are 28) are broad-ranging and cover, inter-alia, the introduction of a non arm’s-length cost rule for software development pools, changes to clarify the cost of a replacement asset (where a depreciating asset was lost or destroyed), amendments to clarify the “holder” of an asset for depreciation purposes (including, in certain sale and lease-back situations), amendments to ensure there is no double tax in certain prescribed situations and amendments to ensure all components of “plant” are included in the definition of a “depreciating asset.”

2.4 Thin capitalisation rules for banks

In response to lobbying by the banking industry, the Government has announced that changes will be made, effective from 1 January 2009, to the thin capitalisation rules that apply to authorised deposit-taking institutions (“ADIs”).

The changes will “clarify” how the following items will be treated for thin capitalisation purposes: treasury shares (i.e. shares in the ADI that the ADI or a related entity holds), the business insurance asset known as “excess market value over net assets,” and capitalised software costs. The amendments will take into account concerns expressed by the banking industry as to how the Australian equivalents of the International Financial Reporting Standards apply to certain aspects of the thin capitalisation arrangements for ADIs.

An exposure draft of the proposed amendments will be released for consultation purposes on the Treasury website.

The Budget announcement, and related Press Release, do not mention whether any thin capitalisation changes are proposed as regards recent moves by some ADI groups to adopt or consider a non-operating holding company (“NOHC”) structure.

2.5 Small business measures

Investment allowance. The Government has announced changes to the legislation currently before Parliament to enact the so-called business tax break.

The current Bill provides a one-off deduction (of either 30% or 10%) for expenditure incurred on qualifying assets within certain time periods. In order to claim the deduction the taxpayer must be entitled to claim depreciation deductions in relation to its expenditure on the asset. In

summary, a 30% tax deduction is available to an entity that contracts to acquire an asset between 13 December 2008 and 30 June 2009 where the asset is used or installed ready for use by 30 June 2010. The relevant window for the 10% deduction is slightly longer.

The Government has announced that it will increase the rate of the investment allowance to 50% for expenditure incurred by small businesses on qualifying assets. The Government has also extended the qualifying time periods for the 50% deduction so that small businesses will be entitled to a 50% deduction if they contract to acquire a qualifying asset in the period from 31 December 2008 to 31 December 2009 where the asset is used or installed ready for use by 31 December 2010. For these purposes, a small business is essentially a business with an aggregated turnover of less than \$2m a year.

Entrepreneurs' tax offset. Other changes have been announced to the entrepreneurs' tax offset. The first of the changes modifies earlier changes announced in the May 2008 Budget. The 2008 Budget had announced the introduction of an income test to the eligibility criteria for the tax offset that would apply from 1 July 2008. The Government has announced in the current Budget that it will defer the application of the income test for 12 months to now apply from 1 July 2009. The Government also announced that it will consult on the form of the new income test.

Non-commercial loss rules. Another Budget announcement proposes that the current exceptions to the provisions deferring losses arising from so-called non-commercial business activities will not be available to individuals with adjusted taxable income of over \$250,000.

Where the current non-commercial loss provisions apply, an individual's deductions attributable to a business activity (including a business activity carried on in a partnership) are quarantined against the current or future income from that business activity. That is, those deductions cannot be utilised against the individual's other income (eg, salary and wages or investment income). The legislated exceptions are threshold tests aimed at identifying activities that are considered sufficiently business-like to escape the operation of the provisions.

This announcement is described as closing a "loophole" in the non-commercial loss provisions which is "exploited" by some 11,000 predominantly high wealth individuals – this exploitation seems to be relying on exceptions currently in the legislation.

Use of private company assets. The Government has announced that the deemed dividend rules for private companies will be extended to the use of real property and chattels (such as cars or boats). Although details are scant, presumably this will be achieved by deeming the market value of the private company shareholder's use of the company's asset (less consideration given by the shareholder) to be an unfranked dividend which is taxable to the shareholder.

The announcement states that the outcome will be greater equity in the treatment between shareholders of private companies and employees more

generally (ie, FBT is generally imposed where an employee uses a company asset for less than market value).

Other technical amendments have been flagged, including a measure to ensure that corporate limited partnerships cannot be used to circumvent the operation of the private company dividend rules.

The amendments will apply from 1 July 2009.

2.6 Carbon Pollution Reduction Scheme

The Budget confirmed that the income tax and GST treatment of emissions units under the proposed CPRS would be as outlined in the exposure draft of the CPRS legislation released on 10 March 2009.

In addition, the Budget announced that all Kyoto units registered in Australia – that is, units issued by a foreign government but surrendered in Australia – would be subject to the CPRS's proposed tax treatment. Any income derived from units registered in Australia will be treated as having an Australian source and, therefore, as assessable in Australia, subject to Australia's Double Tax Treaties. Units held by a taxpayer will be valued at historical cost unless the taxpayer elects the alternative market value method.

For GST purposes, all eligible international units and all Kyoto units will be personal property rights and not real property.

More details on the proposed income tax and GST treatment of transactions with emissions units under the CPRS are contained in our Tax Brief available at http://www.qf.com.au/477_740.htm.

2.7 Petroleum Rent Resources Tax

Petroleum Resource Rent Tax is imposed on "taxable profit" (calculated under the petroleum resource rent tax legislation) from petroleum or gas production projects. In calculating taxable profit, exploration expenditure incurred in relation to "designated frontier areas" is deductible at 150% of the actual amount of the expenditure. The power of the relevant Minister to declare "designated frontier areas" effectively expired in 2008. The Government proposes to revive the power so it can be applied (presumably subject to the old limits in the PRRT legislation) to "the 2009 annual offshore acreage release."

3. International

3.1 The Board of Taxation's Review of CFC and FIF measures

The Government has announced its response to the Board of Taxation's review of anti-deferral measures which began in October 2006. The Board had presented its report to the Assistant Treasurer in September 2008. It was not released until 12 May 2009.

Listed public companies will be disappointed that they have not been provided with an outright exemption from the controlled foreign company (“**CFC**”) regime. Such an exemption was justified to the satisfaction of the Board of Taxation, but was evidently overtaken by the deteriorating revenue forecasts. Although this means listed companies will continue to have a significant compliance burden relative to the tax collected, there are a number of ways in which that burden is being reduced.

The Board made many recommendations, of which only one was completely rejected (the proposed exemption for listed public companies). The other recommendations are to:

- repeal the Foreign Investment Fund (“**FIF**”) and the deemed present entitlement rules;
- rewrite the CFC rules and extend them to closely held fixed foreign trusts;
- exempt tainted sales and tainted services income from the CFC rules;
- modernise the passive income concept;
- exempt complying superannuation funds from attribution under the CFC rules;
- offer alternative methods to calculate attributable income;
- continue to use tax principles for the normal calculation method;
- reshape the “non-portfolio” dividend exemptions to conform with 10% or greater economic equity interests;
- introduce a limited integrity rule to replace the FIF provisions; and
- proceed with transferor trust changes.

The most important of these changes are the repeal of the FIF provisions, the exemption of tainted sales and tainted services income and the re-shaping of the definition of “non-portfolio dividends.”

Although the FIF provisions have been subject to a variety of specific exemptions, they have nevertheless operated harshly on affected taxpayers, especially Australian based managed investment schemes. The Board of Taxation has recommended that the FIF rules should be replaced with a limited integrity rule. The Board’s Report indicates that such a rule should apply only to investments of low risk which are insulated from currency fluctuations. However, it is proposed that the precise scope of the rule is to be settled in consultation when the draft legislation is being developed.

The Board of Taxation has correctly determined that tainted sales income and tainted services income are not really “passive” in nature, and that such amounts should, therefore, be taxed in a manner which permits the relevant CFC to compete in its overseas jurisdiction. If any Australian taxpayers are underpricing sales to such CFCs, or overpaying for purchases, the Australian transfer pricing rules provide the required protection of Australia’s tax base. The removal of these types of tainted income is a sound step in the simplification of the CFC rules.

The definition of a “non-portfolio dividend” is presently controversial, and the proposals represent both good and bad news for taxpayers. Under current law, both Australian companies and CFCs are not assessable to Australian income tax on non-portfolio dividends received from foreign companies, provided their shareholding constitutes at least a 10% unfettered voting interest in the foreign company. The Board has recommended that these rules should be amended so that the dividends only qualify for non-assessment if the investment is an equity interest, as defined under the debt equity rules, of more than 10%. The good news would be that equity interests of that size (or greater) will qualify, whether or not the interest carries voting rights. It remains to be seen whether the equity interest will necessarily have to be a share.

Interestingly, the Government’s response to the Board’s Report does not expressly refer to this “non-portfolio dividend” issue (nor to a related recommendation to repeal section 404 of the ITAA 1936). Nevertheless, they appear to be generically included in the Government’s announcement to implement “all but one” of the Board’s recommendations. That one recommendation was, of course, the proposed exemption for listed public companies.

Treasury Discussion Paper. Apart from the release of the Board of Taxation’s Report and the Government’s response, Treasury has also released a Discussion Paper to form the basis of consultation on the drafting of the new CFC provisions. Although there are limits as to what can be concluded from the Discussion Paper, the following interesting points emerge:

- the distinction between “active” and “passive” income will recognise the degree of activity of the recipient and will not rely solely on the character of the receipt by itself;
- the Board’s recommendation for disregarding income received from other group members may be limited to a country-by-country grouping (instead of global grouping);
- the new definition of “non-portfolio” is likely to be used as a standard in other parts of the tax law; and
- relief for foreign taxes paid on attributed income may be reduced simply to a tax deduction, rather than a tax offset which would be relevant only for attributable taxpayers that are companies.

This is a complex area of Australia’s tax law. There are many additional features which will need to be addressed during the drafting and related consultation process. However, these are generally encouraging changes which could significantly improve the efficiency, equity and simplicity of our tax law. It is a pity that Australian public companies have missed out on the outright exemption that they could reasonably have expected in better economic circumstances.

3.2 Australia-Isle of Man tax agreement

Australia signed a taxation agreement with the Isle of Man on 29 January 2009. An announcement in the Budget has repeated a previous announcement of the Assistant Treasurer on 30 January 2009 that the agreement will be incorporated into Australia's tax law. Indeed, a Bill to do so is already before Parliament.

The agreement is not the kind of comprehensive double tax agreement that Australia has with many other countries. Instead, it only allocates taxing rights between the two countries in the respect of the following types of income: pensions and retirement annuities, income from government service and maintenance, payments to students that are resident of one country but visiting the other country for education or training.

In addition the agreement will provide a mutual agreement procedure for transfer pricing issues (which may be invoked by a taxpayer) and allow for the exchange of information between the countries.

The agreement was signed in conjunction with a tax information exchange agreement with the Isle of Man. Importantly that means that the Isle of Man will become an "information exchange country" so that its residents will be entitled to the lower managed investment trust withholding tax rate of 7.5% (from the 2010-11 year) instead of 30%.

4. Superannuation

4.1 Reduction of the concessional contribution caps

One of the most well-telegraphed leaks in recent budget history was the decision to reduce the concessional contribution caps with effect from the 2009-10 income year. The concessional contribution cap will be reduced from \$50,000 to \$25,000 per annum indexed. The transitional concessional contributions cap (applicable to persons aged 50 and over) will be reduced from \$100,000 to \$50,000 per annum with the cap fading out as originally proposed in the 2011-12 year.

Presently the non-concessional contributions caps are set at 3-times the concessional contribution limit, and so a change to the size of concessional contributions would have flow-on effects for the treatment of non-concessional contributions. However, the cap will be increased to 6-times the level of the indexed concessional contributions cap.

The Government has also announced that the existing grandfathering arrangements concerning the application of the concessional caps to members with defined benefit interests will continue. Moreover, the Government has announced that the arrangements will be extended to certain persons who have defined benefit interests on Budget night (and presumably would not otherwise qualify for the concession).

In short, the Budget proposes no substantive change to non-concessional contributions but a major change to concessional contributions. Clearly, a

substantial incentive exists for superannuants to take maximum advantage of the present concessional cap levels, prior to 1 July 2009.

4.2 Transfer of small and lost accounts

The Government has announced a further “efficiency” measure to require superannuation providers to transfer some superannuation accounts to the Government. This measure will apply to “lost accounts” with balances less than \$200 which have been inactive for 5 years and for which there are insufficient records to identify the owner of the account. Procedures already exist permitting affected members to reclaim lost money from the ATO at any time.

4.3 Account-based pensions draw-down relief

On 18 February 2009, the Government announced some relief for holders of account-based pensions by halving the minimum draw-down amounts for the 2008-09 income year. Unfortunately, this announcement came too late for many pensioners to benefit. The Government has proposed that the measure will be extended to the 2009-10 year. The Government suggests this measure will assist pension account balances to recover from capital losses arising from the global recession.

4.4 Trans-Tasman retirement savings portability scheme

The Government has announced “in principle” agreement to a memorandum of understanding with New Zealand to establish a Trans-Tasman retirement savings portability scheme. Trans-Tasman portability would permit transfers, presumably without taxation being imposed, between “certain Australian superannuation funds” and New Zealand Kiwi Saver funds. The announcement does not define what is meant by the term “certain Australian superannuation funds,” though presumably at a minimum it must include complying funds. It is noted that members of Australian superannuation funds can only transfer retirement savings within the Australian superannuation environment.

The announcement does not indicate the effective date of the revised arrangements.

4.5 Capital loss roll-overs for complying superannuation fund mergers

The Government has re-announced changes to the proposed CGT loss roll-over for complying superannuation fund mergers.

As originally announced on 23 December 2008, the CGT loss roll-over was limited to situations where a complying superannuation fund transferred its assets to another complying superannuation fund that had at least 5 members. In broad terms, the proposed CGT loss roll-over would allow the transferring fund to disregard some or all of any capital losses it would otherwise realise from the merger on an asset by asset basis. Where the transferring fund chooses to ignore a capital loss arising in respect of a particular asset, the receiving fund inherits the transferring fund’s cost base

in that asset. Additional rules apply if the transferring fund uses assets to support pension payments.

As a result of the changes announced in April 2009 and re-announced in the Budget, the CGT loss roll-over will now also apply to mergers involving pooled superannuation trusts where the continuing entity has at least 5 members and to mergers involving the complying superannuation business of a life insurance company.

In addition, the CGT loss roll-over rules will permit superannuation entities in a net capital loss position to roll-over assets with both capital gains and capital losses.

Further, it appears that complying funds will be permitted to transfer realised capital losses or revenue losses.

The proposed CGT loss roll-over will be available for CGT events occurring on and after 24 December 2008 and before 1 July 2011. The Government has committed to reconsider this measure when the Henry Review is completed, with the hope that a more comprehensive CGT roll-over regime will be introduced for superannuation funds.

4.6 Henry Review of Retirement Incomes released

The Government has released the Australia's Future Tax System report into retirement incomes and acknowledged its findings:

- that the three pillar approach (that is, the means-tested Age Pension, compulsory superannuation guarantee and voluntary contributions) be retained;
- greater consideration of the interaction of the tax transfer system and the aged care system is required;
- concern that the longevity risk (the risk that individuals will exhaust their assets before death) is a structural weakness of the superannuation system;
- a general lack of awareness and engagement of individuals with the retirement income system;
- that tax-assisted voluntary superannuation contributions should be more fairly distributed;
- questioning the current cap on concessional contributions – which the Government specifically announced it would act on;
- that the current 9% compulsory rate of saving was appropriate; and
- that preservation age should be gradually increased to 67, subject to further examination of how mandatory retirement ages should be treated.

The Government noted the increase in preservation age would complement its announcement to increase the Age Pension age to 67 by 2023 (starting from 2017 with 65.5 years). It might therefore be expected that an increase in preservation will correspond to increases to the Age Pension age.

4.7 Government co-contribution

Currently, the Government makes a co-contribution of \$1.50 for each \$1 of personal after-tax contributions made by a person who earns under \$30,342 per annum, up to a maximum co-contribution of \$1,500. The maximum possible co-contribution is gradually reduced for persons earnings above the \$30,342 income threshold; persons earning \$60,342 receive no co-contribution.

The rate of Government co-contribution will be temporarily reduced as follows, returning to the present rate of \$1.50 in the 2014-15 year:

Income year	2009-10 20010-11 20011-12	2012-13 2013-14	2014-15
Rate of Government co-contribution	\$1.00	\$1.25	\$1.50
Maximum available co-contribution	\$1,000	\$1,250	\$1,500
Rate of shading out of maximum available Government co-contribution if income exceeds full-contribution threshold	\$0.03333 per \$1 of excess income	\$0.04167 per \$1 of excess income	\$0.05 per \$1 of excess income

4.8 Life insurance – immediate annuity business

This measure seeks to confirm the position that income from assets held by a life insurance company to support immediate annuity policies would be non-assessable non-exempt income to the life insurance company.

This issue initially arose when the provisions dealing with life insurance companies were transferred and re-written from the 1936 tax legislation to the 1997 legislation. The issue concerns the definition of “exempt life insurance policy,” which in its current form excludes certain immediate annuities that were previously exempt under the 1936 Act. It is understood that this measure confirms the initial intention for the definition of “exempt life insurance policy” in the 1997 Act to mirror that in the previous legislation, and is retrospective from 1 July 2002.

Additionally, from the 2008 income year, immediate annuities that are superannuation income streams would no longer need to satisfy the immediate annuity conditions to qualify as exempt life insurance policies. This aligns life insurance companies with other providers of superannuation income streams by ensuring that income from assets supporting such income streams is exempt to all providers. Further, the removal of the immediate annuity conditions also removes the need for a life insurance company to track the undeducted purchase price of the superannuation income stream annuities for the purposes of obtaining an exemption from tax.

Overall, it is noted that the measures do not represent any practical change to the tax law as it is understood to apply. These measures correct issues in the technical application of the tax law to life insurance business, that have been previously acknowledged as unintended deficiencies that required amendment. A short discussion paper on the design of the amendments was released tonight by Treasury.

5. Tax Administration

The Budget announced a large number of minor changes to the law and procedures governing tax administration.

International tax debt collection. The Budget announced – as if it were a new measure – legislation that commenced from 26 March 2009 to enhance the Commissioner's ability to collect moneys on behalf of foreign revenue authorities in accordance with Australia's double tax treaty obligations.

Australian Business Register amendments. Tax Laws Amendment (2009 Measures No 2) Bill 2009 was introduced into Parliament on 19 March 2009 and contains measures to improve the efficiency of the Australian Business Register. This measure was re-announced in the Budget.

Closely-held trust TFN withholding. From 1 July 2010, the TFN withholding regime will be expanded to include distributions by closely-held trusts, including family trusts, where the beneficiary has not quoted their TFN. As with other TFN withholding provisions – eg, interest earned on bank accounts – the trustee would be required to withhold at 46.5% from distributions to a beneficiary who has not quoted their TFN. Where TFN withholding applies, the beneficiary will be entitled to a tax credit for the withheld amount.

GDP-adjusted PAYG instalments. This measure, announced on 28 March 2009, will reduce the GDP adjustment (where applicable) when calculating PAYG instalments for the 2009-10 income year. The GDP adjustment, otherwise expected to be about 9%, will be reduced to 2% to reflect CPI growth. The recent headline GDP figures would seem inconsistent with a 9% GDP uplift factor. This is explained in that the headline GDP is quoted in real terms, whereas the GDP adjustment for PAYG is calculated using nominal dollars.

Repeal of unlimited amendment period provisions. The Government announced that it will review over 100 provisions in the income tax law that provide an unlimited period in which the Commissioner may amend a taxpayer's assessment. No further details were provided as to exactly which amendment provisions might be repealed.

6. GST

As expected, in addition to re-announcing existing measures, the GST centrepiece of the Budget is an indicative response to the Board of Taxation's review of GST administration. However, two reviews announced

in the Budget – into the margin scheme for real property and the financial supply system – will probably prove to be of more lasting significance.

6.1 Review of the margin scheme

The announced review of the margin scheme has been eagerly awaited by the property industry. The Discussion Paper released with the announcement makes it clear that the entirety of the regime is open for discussion.

Three options reform options are canvassed:

- retain the margin scheme, but replace the legislative framework with a clear statement of principles, including procedural rules. These principles would be to the effect that GST should not be payable on the value of property that has previously borne GST, GST is not payable on the change in the value of property while held by an unregistered entity and that GST is not payable on the pre- 1 July 2000 value of property;
- abolish the margin scheme entirely and replace it with a notional input tax credit rule similar to that applying to second hand goods; or
- a series of technical amendments to the existing rules. These changes could include rules to deal with the potential for the multiple inclusion of changes in value in the calculation of the margin, the vagaries of the valuation process, the interaction of the margin scheme with other GST provisions, the difficulties of applying the rules to partnerships and various unintended policy outcomes such as those outlined in recent Taxpayer Alerts.

This is clearly a major review with far-reaching implications for the property sector and one that will need to be considered in detail. Submissions are due by 31 July 2009.

6.2 Review of the taxation of financial supplies

Equally eagerly awaited, and the subject of much lobbying, is the review into the financial supply provisions. Again, submissions are due by 31 July 2009.

Importantly, the review “will not reconsider the key policy parameters” of the input taxed treatment of financial supplies. So, it appears that the GST-free treatment of business-to-business financial supplies that many had pressed for is not on the agenda.

What will be considered are measures to reduce the complexity and inconsistencies of the existing rules, including:

- replacing the existing legislative framework with one based on a clearly expressed set of principles;
- amending the existing law to clarify ambiguities; and
- revising the 75% reduced input tax credit regime.

The review will expressly not consider the reverse charge mechanism, the provisions governing change of use, the financial acquisitions threshold, the interaction of GST with FBT or apportionment methodologies.

This too is a significant review. The taxation of financial supplies lie at the heart of many of the GST problems faced by taxpayers. Simplification is both necessary and desirable.

6.3 Response to the Board of Taxation's review of GST administration

It appears that 26 of the 31 GST-related recommendations made by the Board of Taxation are supported by the Government. Of those, 16 will be implemented shortly and the remainder the subject of further review.

Responses deserving particular note include proposals:

- to streamline the "change in use" provisions;
- to overlook minor informalities in tax invoices so that they do not preclude the claiming of input tax credits if other supporting documentation is held;
- to confirm the ability to defer claiming an input tax credit to later tax periods, but with a strict 4 year limit;
- to amend the indirect rulings program to mirror that for income tax, allowing objections against unfavourable private rulings. One party to a transaction will be able to rely on a private ruling obtained by another; and
- to adopt "more principled and flexible GST grouping rules" in line with the Board's recommendations.

The Board has been asked to review (reporting by February 2010) the application of the GST system to non-residents.

6.4 Other GST Measures

The other key measure in the Budget is the previously announced amendments to the GST Act to counter a recent decision affecting "representatives of incapacitated entities" (eg, liquidators, administrators etc). The amendment is intended to ensure that representatives are personally liable for GST with effect from 1 July 2000. This accords, for the most part, with the positions adopted by most insolvency practitioners and so should not have significant impact.

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These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.

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