

2008 Budget

Personal income tax cuts

The Government will deliver in full the tax cuts it announced during the 2007 election campaign (including deferring the previously budgeted reductions in the top marginal tax rate until beyond 2010-11), as follows:

| Current (2008) tax thresholds | Tax rate (%) | New tax thresholds from 1 July 2008 | Tax rate (%) |
|-------------------------------|--------------|-------------------------------------|--------------|
| 0 - \$6,000 | 0 | 0 - \$6,000 | 0 |
| \$6,001 - \$30,000 | 15 | \$6,001 - \$34,000 | 15 |
| \$30,001 - \$75,000 | 30 | \$34,001 - \$80,000 | 30 |
| \$75,001 - \$150,000 | 40 | \$80,001 - \$180,000 | 40 |
| \$150,001+ | 45 | \$180,001+ | 45 |

| New tax thresholds from 1 July 2009 | Tax rate (%) | New tax thresholds from 1 July 2010 | Tax rate (%) |
|-------------------------------------|--------------|-------------------------------------|--------------|
| 0 - \$6,000 | 0 | 0 - \$6,000 | 0 |
| \$6,001 - \$35,000 | 15 | \$6,001 - \$37,000 | 15 |
| \$35,001 - \$80,000 | 30 | \$37,001 - \$80,000 | 30 |
| \$80,001 - \$180,000 | 38 | \$80,001 - \$180,000 | 37 |
| \$180,001+ | 45 | \$180,001+ | 45 |

The Government has also set an aspirational tax goal over six years, for a personal income tax system which reduces the number of rates from four to three, with a personal income tax scale of 15%, 30% and 40%.

Medicare levy low income thresholds

The 2007-08 Medicare Levy low-income thresholds will be as follows:

- Individuals \$17,309 (previously \$16,740)
- Families \$29,207 (previously \$28,247)

The additional amount of threshold for each dependent child or student will also be increased to \$2,682 (previously \$2,594).

Medicare levy surcharge thresholds

From 1 July 2008, the Medicare levy surcharge thresholds will be increased for singles (from \$50,000 to \$100,000) and for those who are members of a family (from \$100,000 to \$150,000). These thresholds apply for taxpayers who do **not** have adequate private health insurance.

Low income tax offset ('LITO')

From 1 July 2008, the low income tax offset will increase from \$750 to \$1,200. From 1 July 2009, it will increase further to \$1,350 and from 1 July 2010 to \$1,500. The tax offset will continue to be phased-out once taxable income exceeds \$30,000 (i.e., the LITO will be reduced by 4 cents for every \$1 of taxable income above \$30,000).

Those eligible for the full low income tax offset will have a tax-free threshold as outlined below:

| | LITO | Tax-free threshold (Adult) | Tax-free threshold (Child under 18) |
|-----------------|-------------|---------------------------------------|--|
| 2008-09: | \$1,200 | \$14,000 | \$2,667 |
| 2009-10: | \$1,350 | \$15,000 | \$3,000 |
| 2010-11: | \$1,500 | \$16,000 | \$3,333 |

Senior Australians Tax Offset ('SATO')

The amount of income a senior Australian eligible for the senior Australians tax offset can earn before they incur an income tax liability will increase to the following amounts:

| | 2008-09 | 2009-10 | 2010-11 |
|----------------|----------------|----------------|----------------|
| Singles | \$28,867 | \$29,867 | \$30,685 |
| Couples (each) | \$24,680 | \$25,680 | \$26,680 |

The relevant Medicare levy low-income threshold will be increased to ensure that senior Australians do not pay the Medicare levy until they begin to pay income tax.

Dependant tax offsets – restricted eligibility

From 1 July 2008, an income threshold of \$150,000 (indexed) will apply when determining a taxpayer's eligibility for claiming a Dependent Spouse, Housekeeper, Child Housekeeper, Invalid Relative and Parent/Parent-in-law tax offset.

From 1 July 2009, the Government will align the definition of "income" for these tax offsets with that applying to family assistance payments.

Child care tax rebate – greater claims

From 1 July 2008, the child care tax rebate (which is paid through the Family Assistance Office) for out-of-pocket child care expenses will increase from 30% to 50%, and the maximum claim will increase from \$4,354 to \$7,500 (indexed) per child, per annum.

First Home Saver Accounts

The First Home Saver Account ('FHSA') initiative will allow Australians to save larger deposits for their first home. Eligible individuals will be able to make post-tax contributions into an FHSA, and these contributions will be partly matched with a Government contribution. Furthermore, earnings on the account will be taxed concessional at 15%.

The proposed FHSA initiative has been amended following the Government's recent consultation process. The following key changes to the original proposal will be made:

- The commencement of this initiative has been deferred to 1 October 2008;
- Annual contributions into an FHSA will no longer be capped. Instead, once the account balance reaches \$75,000 (indexed), additional personal contributions **cannot** be made;
- There will **not** be a requirement to make a \$1,000 contribution when opening an account; and
- The Government will contribute 17% of up to \$5,000 of personal contributions into an FHSA each year (previously, between 15% and 30% of personal contributions of up to \$5,000).

Education tax refund

From 1 July 2008, families receiving FTB Part 'A' with children undertaking primary or secondary studies will be eligible to claim a refundable tax offset in respect of eligible education expenses incurred from this date (e.g., laptops, education software, school text books and stationery). The tax offset will be claimed through the individual tax return for the relevant income year.

Eligible parents will be able to claim the following:

- A 50% tax offset each year for up to \$750 of education expenses for each child attending **primary school** (i.e., a maximum tax offset of \$375 per child, per year).
- A 50% tax offset each year for up to \$1,500 of education expenses for each child attending **secondary school** (i.e., a maximum tax offset of \$750 per child, per year).

Entrepreneurs' tax offset – restricted eligibility

From 1 July 2008, eligibility for the entrepreneurs' tax offset ('ETO') will be subject to an income test. Currently, the ETO provides a 25% tax offset for small businesses with an annual turnover of less than \$75,000 (which begins to phase out for a turnover greater than \$50,000).

However, before the ETO can be claimed from 1 July 2008, single taxpayers will be required to have an annual adjusted taxable income of no more than \$75,000, and families will be required to have an annual adjusted taxable income of no more than \$120,000.

Fringe benefits tax initiatives

The following fringe benefits tax ('FBT') initiatives were announced:

1. **Eligible work-related items** – the FBT exemption for certain work-related items (e.g., laptop computers, personal digital assistants and tools of trade) will **only** apply where the item is used primarily for work purposes, for items purchased after 13 May 2008.

Furthermore, the FBT exemption will be extended to all work-related portable electronic devices (including those with multiple functions) acquired after this date.

However, for FBT exempt work-related items purchased after 13 May 2008, employees will be denied depreciation deductions. For items purchased before this time, depreciation will be denied for the 2009 and later income years.

2. **Jointly held assets** – for new arrangements entered into after 13 May 2008, the FBT rules will be amended to ensure the full value of a benefit provided jointly to an employee and their associate (e.g., reimbursement of a jointly incurred rental property expense) is subject to FBT.

Employees who have already entered into salary sacrifice arrangements will be able to utilise existing arrangements until 31 March 2009.

3. **Meal cards** – from 13 May 2008, the property benefit exemption under S.41 will no longer apply to meals provided on an employer's business premises under a salary sacrifice arrangement. Existing balances on meal cards will remain eligible for the exemption as long as they are used by 31 March 2009.

This measure will **not** affect subsidised canteens that are provided to all staff and that are not part of a salary sacrifice arrangement.

Capital gains tax initiatives

The following capital gains tax ('CGT') initiatives were announced:

1. **Small business concessions ('SBCs') extended** – from 1 July 2007, an asset owned by a non-SBE ('Small Business Entity') will be eligible for the SBCs if the asset is used by a related entity. The same will apply for a partner owning an asset used by the partnership.

2. **Cancellation of interests in widely held entities** – from the 2007 income year, where shares or units in widely held entities are cancelled or surrendered, a taxpayer will be able to calculate their capital gain (or loss) using the actual proceeds received (rather than the share or unit's market value at the time of cancellation).

3. **Scrip-for-scrip roll-over modification** – the CGT scrip-for-scrip roll-over will be amended from 13 May 2008 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 entity's net assets.

Currently, the acquiring entity obtains a market value cost base for the shares it acquires in the target entity, which can result in significant unintended tax benefits.

4. **Demutualisation of health insurers (CGT relief)** – effective from 1 July 2007, CGT relief will be available to policy holders of health insurers who receive shares when their insurer demutualises, basically as follows:

- pre-CGT policy holders will receive a market value cost base for their shares; and
- post-CGT policy holders will receive a cost base that is based on their share of the health insurer's net tangible assets.

Depreciation – computer software

The period over which capital expenditure on in-house computer software is depreciated will be increased from 2.5 years to 4 years for expenditure incurred after 13 May 2008. Depreciation claims will continue to be made on a straight line basis.

In-house computer software is basically software that is acquired or developed that is mainly used by the taxpayer in performing the functions for which the software was developed (i.e., it is **not** for resale), such as off-the-shelf software.

Employee share scheme initiatives

The following two employee share scheme ('ESAS') initiatives were announced:

1. **ESAS election requirements** – for qualifying shares and rights acquired on or after 1 July 2008, there is change to the election procedure.

Currently an employee can elect to be taxed on a discount in relation to qualifying shares or rights in the year of acquisition. Where an election is not made, the tax liability on the discount is deferred until a later time (e.g., when restrictions on the shares or rights are lifted).

It appears that, under this measure, where an employee elects to be assessed up-front (on their discount), but the taxable discount is **not** included in the employee's tax return, the employee will be taxed under the 'deferral option' (i.e., as if an election has **not** been made).

2. **Removal of double taxation** – for CGT events happening after 13 May 2008, CGT relief will be provided in relation to certain employee share schemes that involve the use of employee share trusts (i.e., where rights are exercised to acquire shares in a company).

Family trusts – utilising losses

From 1 July 2008, the following two measures will basically affect the use of family trust elections:

- (a) The definition of family (in the family trust election rules) will be changed in order to limit lineal descendants to **children** or **grandchildren** of the test individual or of the test individual's spouse.
- (b) Family trusts will be precluded from making a one-off variation to the test individual specified in a family trust election (other than in relation to a marriage breakdown).

Managed investment funds – final withholding tax on certain distributions to foreign residents

The current 30% non-final withholding tax on distributions of Australian source net income (other than dividends, interest and royalties) from Australian managed investment trusts to foreign residents will be replaced by a final withholding tax regime.

The final withholding tax regime will differ according to whether the foreign investor is a resident of a jurisdiction with which Australia has effective exchange of information arrangements on tax matters (to be specified by regulation), basically as follows:

- (a) For residents of such jurisdictions – the following withholding tax rates will apply:
- For 2008-09^① – a non-final tax rate of 22.5%;
 - For 2009-10 – a final tax rate of 15%; and
 - For 2010-11 and later years – a final tax rate of 7.5%.
- (b) For residents of other jurisdictions – a final withholding tax rate of 30% will apply (from the income year in which the amending legislation receives Royal Assent).
- ① *For the first year (i.e., 2008-09), as an interim measure, such residents will be eligible to claim deductions for expenses relating to their fund payments. These residents will be taxed at a new rate of 22.5% on an amount net of any deductions.*

Capital protected borrowings – benchmark rate

For capital protected borrowing arrangements entered into after 13 May 2008, the benchmark interest rate will be adjusted to increase the capital component of the overall expense.

Under a typical capital protected borrowing arrangement, the investor uses borrowed funds to buy listed shares but is protected from a fall in their price by a capital protection feature. The benchmark interest rate is used to determine how much of the interest on the borrowing is attributable to the cost of this capital protection (i.e., the non-deductible portion).

The current rules will continue to apply to existing arrangements for five years or the life of the product, whichever is the shorter.

Means testing of government support – expanding the definition of ‘income’

With effect from 1 July 2009, the definition of income which is used to determine eligibility for certain government support programs will be expanded in the following three areas:

- (a) **Salary sacrificed superannuation contributions** – the definition of income will include salary sacrificed superannuation contributions for the purposes of determining eligibility for certain government support programs, such as:
- superannuation co-contributions;
 - income support payments for people below Age Pension age;
 - family assistance and child support; and
 - financial and retirement savings assistance delivered through the tax system.
- (b) **Net investment losses** – the definition of income will be expanded to include ‘net financial investment losses’ and ‘net rental property losses’, where appropriate, when determining whether an individual is entitled to claim, or is liable for, any of the following:
- Senior Australians tax offset;
 - Medicare levy surcharge; and
 - Dependant tax offsets (e.g., spouse tax offset).

- (c) **Reportable fringe benefits amounts** – the definition of income will be expanded to include 'reportable fringe benefits', when determining eligibility for the following tax offsets:
- Senior Australians tax offset;
 - Pensioner tax offset; and
 - Dependant tax offsets (e.g., spouse tax offset).

Other budget announcements

Further initiatives announced in the 2008 Federal Budget include the following:

- (a) From 1 July 2008, all deductions for **donations** to **political parties** will be removed.
- (b) From 1 July 2008, the **luxury car tax** rate will increase from 25% to 33%.
- (c) The Government has deferred, until 1 July 2009, the measure to align the PAYG instalments and GST payment and reporting requirements for taxpayers who are voluntarily registered for GST.
- (d) From 1 July 2008, the **baby bonus** will increase from \$4,258 to \$5,000, and from 1 January 2009, eligibility for the baby bonus will be limited to families with income of \$75,000 in the six months after the birth of the child (effectively \$150,000 per annum).
- (e) **Family tax benefit** ('FTB') **Part 'B'** will be limited to those families where the primary income earner has an adjusted taxable income of no more than \$150,000 per annum.

Furthermore, from 1 July 2009, FTB will **only** be delivered through Centrelink and Medicare, and not through the Tax Office.

- (f) The Government has announced its plans in relation to the following previously announced **GST measures**:
- A package of GST changes for charities and other not-for-profit organisations announced by the previous government will **not** proceed;
 - A measure previously announced in the 2007-08 Budget that ensures certain telecommunication services would remain GST-free from 1 July 2000 will be amended to apply **only** to mobile telephone global roaming services; and
 - A new measure will ensure that where the margin scheme is used after a GST-free or non-taxable supply, the value added by the registered entity which made that supply is included in determining the GST subsequently payable under the margin scheme.
- (g) The eligible investment business rules will be modified to reduce compliance costs and uncertainty for managed funds, especially property trusts (from the date of Royal assent).

Under these rules, managed funds that limit their activities to certain investments (e.g., investing in land primarily for rent), retain trust taxation treatment rather than being taxed like companies. The measure will:

- clarify the scope and meaning of investment in land for the purpose of deriving rent;
- introduce a 25% allowance for non-rental income from investments in land (excluding capital gains); and
- expand the range of financial instruments that a managed fund may invest in or trade.