



Federal Budget Brief 2009

A review of the Budget's
major tax implications

AUSTRALIA

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Executive comment

A difficult Budget for tough times

The rivers of gold from corporate tax revenue that characterised previous Budgets have slowed to a trickle and uncertainties in the global economy present unique challenges for those charged with forecasting future revenue flows.

Last year's Budget forecast a surplus of over \$22 billion for 2008-09 and focused on reducing inflation and making allocations to infrastructure funds. The 2008-09 financial year is now expected to result in a deficit of almost \$33 billion, growing to a deficit of more than \$58 billion for 2009-10, reflecting the extent to which economic circumstances have changed.

Some of the budgetary pressures are a result of the economic downturn reducing revenues and increasing outlays such as welfare payments. Others have arisen as a result of discretionary expenditure announced since the last Budget, including the stimulus packages which incorporated \$23 billion in immediate transfer payments and almost \$29 billion for infrastructure and other capital expenditure.

Australia faces the prospect of Budget deficits for the forecast period and it is unlikely there will be any further reductions in personal income tax rates beyond the measures already legislated.

The *Australia's Future Tax System Review (AFTS Review)*, also known as the *Henry Review*, has the objective of setting a tax reform agenda well beyond the current Budget horizon. Measures announced in this Budget to reduce business tax compliance costs, simplify some tax provisions and involve private sector experts in the tax legislative process auger well for the direction of this review.

Despite the current fiscal outlook, the Australian Government should not be unduly constrained from introducing necessary future reforms to the tax system to maximise Australia's economic opportunities when the global economy returns to growth.

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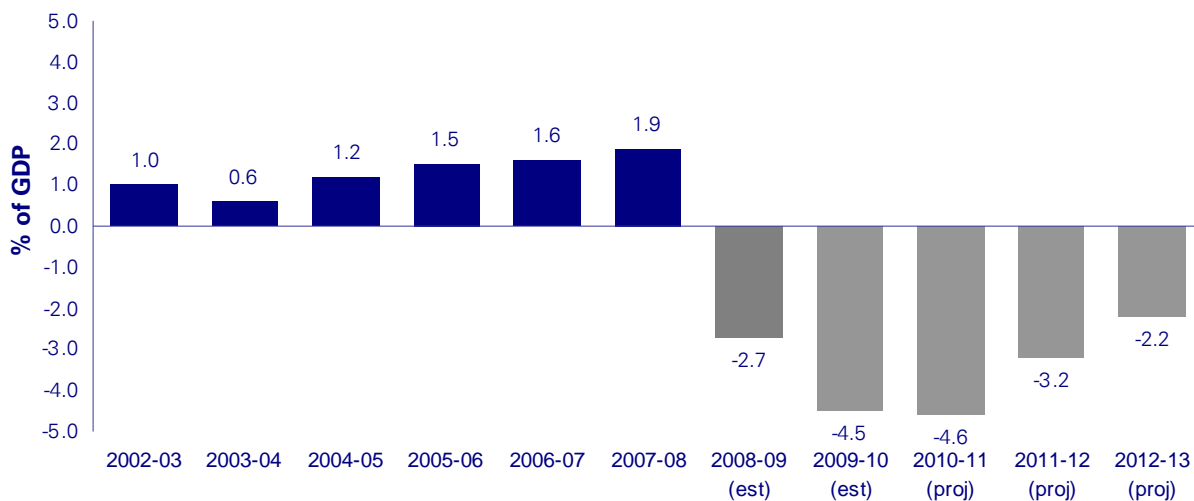
Economic and fiscal analysis

The Treasurer's second Budget has forecast an Australian economy which will be characterised by a 0.5 percent fall in GDP, inflation of 1.75 percent and unemployment rising significantly to 8.25 percent.

Surpluses disappear, deficits loom

This Budget, and the projections for the following financial years, are anticipated to be in deficit until 2015-16 due to negative or low growth forecast for the Australian economy, a collapse in tax revenue and increased discretionary spending by the government.

Underlying budget balance



The estimated final outcome of the 2008-09 Budget will be a \$32.9 billion deficit, compared with the original forecast of a surplus in excess of \$22 billion.

Total taxation revenue in 2009-10 is estimated to be \$267.7 billion. At \$122.7 billion, personal income tax remains the largest single revenue item, but this will decrease by almost \$3 billion, or 2.4 percent, due to the personal income tax cuts and the economic conditions.

Corporate tax collections are expected to yield \$2.8 billion less revenue, falling to \$56.7 billion over the next financial year. The key factor driving the fall in revenue has been corporate tax receipts which, having decreased by 10.6 percent over the past financial year, are predicted to decrease by a further 4.8 percent in 2009-10.

The state and territory governments will continue to benefit from the projected GST revenue growth of \$0.5 billion in 2009-10.

Key revenue items

The following table sets out the income raised by key revenue items since the 2007-08 income year:

	2007-08 (\$'000,000)	2008-09 (\$'000,000)	2009-10 (\$'000,000)	Change on 2008-09 (%)
Personal income tax	126,135	125,690	122,710	-2.4%
Corporate income tax	66,661	59,550	56,700	-4.8%
FBT	3,796	3,470	3,460	-0.3%
Superannuation taxes	11,988	9,160	7,990	-12.8%
Excise and other indirect taxes	33,269	34,751	33,237	-4.4%
GST	44,381	43,130	43,630	1.2%
Total federal tax revenue	286,230	275,751	267,727	-2.9%

Personal taxation

Personal tax rates and thresholds

As widely anticipated, the Budget confirmed the following, already enacted, personal tax rates and thresholds for the 2009-10 and 2010-11 income years. Clearly the significant revenue constraints now faced by the government have curtailed the prospect of its original aspirational marginal tax rates of 15, 30 and 40 percent by 2013-14.

Current rates from 1 July 2008		Enacted rates from 1 July 2009		Enacted rates 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

Note: Excludes 1.5 percent Medicare levy

The Budget also announced the following related measures:

- Confirmation of the previously announced increase in the maximum amount of the low income tax offset (LITO) from the current \$1,200 to \$1,350 in 2009-10 and \$1,500 in 2010-11.
- From 1 July 2009, an increase in the Medicare levy low-income threshold to \$17,794 for individuals and \$30,025 for individuals who are members of a family.
- From 1 July 2010, a sliding reduction in the 30 percent private health insurance tax offset for taxpayers with a taxable income of more than \$75,000 (\$150,000 for couples) with no offset for taxpayers earning more than \$120,000 (\$240,000 for couples).
- From 1 July 2010, an increase in the Medicare Levy Surcharge applying to taxpayers without eligible private health insurance from 1 percent to 1.25 percent of taxable income for taxpayers earning more than \$90,000 (\$180,000 for couples) and to 1.5 percent of taxable income for taxpayers earning more than \$120,000 (\$240,000 for couples).

Other related personal tax and family benefit announcements included:

- From 1 July 2009, the abolition of the foreign service income exemption for taxpayers other than certain aid and charitable workers who spend a period of more than 90 continuous days working overseas. Any double taxation will be addressed with a foreign tax offset for any foreign tax paid.
- From 1 July 2009, the tightening of the application of the non-commercial loss rules to prevent individual taxpayers with an adjusted taxable income of over \$250,000 offsetting excess deductions from non-commercial business activities against salaries and other income. Such losses will be quarantined against income derived by the business activity, although affected taxpayers will have the ability to apply to the Commissioner of Taxation (the Commissioner) for relief in exceptional circumstances or because the nature of the activities means that a taxpayer is temporarily carrying on an uncommercial business but the activities they are undertaking are nonetheless independently assessed as commercially viable.
- From 1 July 2009, reform of the indexation arrangements and upper income thresholds that are part of the family tax benefit system.
- The deferral of the entrepreneurs' tax offset income test, as proposed in the 2008-09 Budget, for 12 months, and the announcement of proposed consultation on the form of the test which will apply from the 2009-10 financial year.
- From January 2011, the phased introduction of a government funded paid parental leave scheme involving payment of the federal minimum wage (currently just under \$544 per week) for 18 weeks.

Employee share schemes

The government proposes to change the law to tax all discounts on employee shares and share options at the time of receipt. It would appear this may be the case even where the employee cannot yet sell the shares, or may never become entitled to exercise the options or keep the shares. The announcement significantly inhibits the use of employee share schemes as a form of remuneration and equity participation.

With effect from 7:30pm on 12 May 2009 the value of any discount on shares and rights to acquire shares granted to employees will therefore be taxed in the hands of the employee in the year in which they are granted. However, employees who earn less than \$60,000 of taxable income (adjusted for reportable fringe benefits, salary sacrificed superannuation and net rental losses) may still be eligible for the existing \$1,000 exemption, provided that the employee share plan meets the qualifying conditions.

This announcement is likely to have immediate and significant consequences for many employee share schemes currently in operation.

Removing payments to DGRs from the scope of FBT

The Budget reconfirmed the government's announcement, in the wake of the February 2009 bushfires, that it would introduce legislation to remove payments to deductible gift recipients (DGRs) from the scope of fringe benefits tax (FBT) effective from 1 April 2008, the start of the 2008-09 FBT year.

Remuneration planning

The FBT rate for the year ending 31 March 2010 remains at 46.5 percent and there were minimal changes announced in respect of the FBT regime. Nevertheless, the reduction in the marginal tax rate of taxpayers with a taxable income of between \$80,000 and \$180,000 from 40 percent to 38 and 37 percent, together with the availability of the proposed investment allowance to employers/financiers with respect to motor vehicles, means there may still be a number of new remuneration planning decisions that will need to be made in the short to medium term.

Furthermore, the above changes to the employee share scheme rules could also impact remuneration planning.

Superannuation

Reduced concessional contribution cap

As widely rumoured before the Budget, the government announced a 50 percent reduction in the concessional contributions cap to \$25,000 (or \$50,000 for those over the age of 50) which will apply to contributions made during the 2009-10 financial year. For those aged over 50, the concessional contributions cap will reduce to \$25,000 in 2012-13. The existing concessional contributions cap of \$50,000 (or \$100,000 for those over the age of 50) will continue to apply for the full 2008-09 financial year.

The non-concessional contributions cap will remain at \$150,000 for the 2009-10 financial year. Commencing in the 2010-11 financial year, the non-concessional contributions cap will be calculated as six times the level of the (indexed) concessional contributions cap. The ability to make up to \$450,000 in non-concessional contributions over a 3-year period appears to remain intact.

For defined benefit schemes, the current 'grandfathering' provisions for notional taxed contributions will continue to apply for funds with defined benefit interests at 12 May 2009.

Reduction in government co-contribution

A temporary reduction was announced in the personal contribution amounts that will be matched by the government via the superannuation co-contribution scheme. The superannuation co-contribution matching rate, currently at 150 percent, will be reduced to 100 percent for contributions during the 2009-10, 2010-11 and 2011-12 financial years.

The temporary reduction will subside in the 2012-13 and 2013-14 financial years where the maximum co-contribution payable will increase to \$1,250. The current co-contribution matching rate of 150 percent will return during the 2014-15 financial year.

Account-based pension extended drawdown relief

The minimum drawdown relief for account-based pensions, which allows pensioners to reduce the minimum pension payment required by 50 percent, has been extended for another 12-month period, continuing the relief for the 2009-10 financial year.

This means for a person under the age of 65, only 2 percent of an account-based pension is required to be paid over the 2009-10 financial year.

Portability scheme allowing rollover between Australia and New Zealand

Transfers of superannuation savings between certain Australian superannuation funds and New Zealand *KiwiSaver* funds will be permitted after the signing of a memorandum of understanding, designed to enable the streamlining and consolidation of retirement savings between the two countries.

Changes to unclaimed monies

Amendments have been announced, effective 1 July 2010, that will require superannuation funds to transfer the following accounts to unclaimed monies:

- lost accounts with balances under \$200
- accounts that have been inactive for five years and for which there are insufficient records to identify the account (insoluble accounts).

Age pension reforms

Additional reforms to the age pension were also announced, including a progressive increase in the eligible age for the age pension to age 67 by 2023, and increases in the base rate of the age pension as follows:

- Single pensioners will receive a maximum additional \$32.49 per week, or \$1,689 per year.
- Pensioner couples will receive a maximum additional \$10.14 per week (combined), or \$527 per year.
- In addition to any pension increase, pensioners engaging in some part-time work may be entitled to an extra benefit of \$125 per fortnight.
- A maximum of \$250 earnings per fortnight will be excluded from means testing, with the reduction in employment income earned under the income test.
- Age and service pensioners earned income will be treated more generously with the introduction of a new Work Bonus.

Business taxation

General business-related budget announcements

Recent budget announcements in countries such as the UK and Canada have seen a number of business tax initiatives including increases in capital allowance rates, relaxation of the loss utilisation regimes, establishment of strategic investment funds and the postponement of adverse business tax measures.

In contrast, the perceived need to adhere to promised Australian personal tax cuts has left the government with little room to provide additional short-term tax relief to business, notwithstanding the current economic climate. Longer-term business tax reform will have to await the outcomes and recommendations of the *AFTS review*.

The business tax measures that the government has announced, outside the scope of the various government responses to various tax review recommendations, include:

- The proposed 30 percent investment allowance will be increased to 50 percent but only for small businesses with an annual turnover of less than \$2 million. There has also been an extension of the dates by which qualifying assets can be acquired and installed to obtain the increased 50 percent allowance. Despite extensive business lobbying, the Budget did not announce any further changes to the scope of the proposed investment allowance. Business taxpayers with turnover of more than \$2 million should note that to obtain the benefit of the proposed 30 percent investment allowance deduction, contract orders still effectively need to be in place by 30 June 2009.
- From 1 July 2009, amendments will be made to the private company loan rules contained within Division 7A to ensure the provisions will also apply to include payments made by way of licence or right to use real property and chattels. Integrity provisions will also ensure that corporate limited partnerships cannot be used to circumvent the intent of the provisions.
- From 1 January 2009, the thin capitalisation rules will clarify how treasury shares, the previous insurance asset known as excess market value over net assets and capitalised software costs, will be recognised under the thin capitalisation rules applicable to authorised deposit taking institutions (ADIs). The changes are in response to industry concerns regarding the adverse impact on the thin capitalisation ratios of ADIs since the reclassification of these types of assets under International Financial Reporting Standards took effect.
- Certain income tax provisions that provide for unlimited amendment periods will be repealed with effect from the date of Royal Assent of the enabling legislation. The government considers that for these provisions the Commissioner has sufficient time under the general amendment period provisions to review an assessment.
- A number of technical amendments to the capital allowances regime, some retrospective to 1 July 2001, will remove anomalies, clarify legislative interactions and ensure that the provisions operate fairly and as intended.

Announced CGT treatment for managed investment trusts

A number of Budget announcements related to the government's response to tax reviews and reports conducted by various bodies to date.

As expected, the government will accept the Board of Taxation's (the Board) recommendation to provide deemed capital gains tax treatment on disposal of investment assets by managed investment trusts (MITs) with effect from the 2008-09 income year.

It has been general practice within the unit trust industry to recognise most assets as held on capital account. Unfortunately there is no clear authority or guidance for this approach and the ATO had previously indicated they considered a significant amount of gains derived from asset disposals to be on revenue account. This ambiguity had significant ramifications in terms of eligibility for the capital gains tax (CGT) discount and the taxation treatment of non-resident investors (who are not subject to tax on distributions of capital gains unless the gains are derived from taxable Australian property).

The government announcement confirming CGT treatment on the disposal of investment assets is welcome news, as it will promote certainty within the industry and provide greater alignment with the tax treatment of the underlying investors.

Australian MITs will be required to make an irrevocable election to apply the CGT treatment to eligible asset disposals from the first income year commencing on or after the 2008-09 year. The definition of an MIT is currently contained within the withholding tax provisions, but importantly, since the Board is continuing to review the taxation treatment of MITs with a final report due by mid-2009, this definition may be subject to change at some later date.

The announced concessions will also apply to unit trusts 100 percent owned and controlled by MITs if the trust meets the eligible business requirements in Division 6C. It will also be interesting to observe whether the concession will extend to collective investment vehicles other than MITs, such as Listed Investment Companies, which typically have their portfolio taxed on revenue account.

Commissioner's discretion in tax law interpretation

The Tax Design Review Panel's (TDRP) August 2008 report entitled *Better Tax Design and Implementation* (the Report) examined ways to reduce delays in the enactment of tax legislation and improve the quality of tax law changes. The Report made 26 recommendations proposing significant changes to existing processes for tax design, all of which the government accepted in principle, and many of which have been implemented.

As part of the Budget, the government released a public discussion paper in respect of one of the TDRP's outstanding recommendations, namely to consider whether the Commissioner should be given further power to modify the tax law to give relief to taxpayers, or whether there are preferable ways in which the Commissioner could provide extra-statutory concessions in appropriate circumstances.

While there are advantages to the implementation of this recommendation, including the faster resolution of issues via the grant of extra-statutory concessions, disadvantages may include a weakening of the rule of law and a possible creation of further uncertainty for taxpayers.

International tax developments

In October 2006, the government requested the Board to review the effectiveness and efficiency of Australia's attribution rules, including the existing controlled foreign company (CFC) and foreign investment fund (FIF) rules. The Budget announced the government's response to the recommendations arising from this review.

The proposed measures seek to enhance Australia's international competitiveness by reducing the complexity and compliance costs associated with the current anti-deferral regime without compromising Australia's revenue base. That is, the government has sought to enhance Australia's attractiveness as a regional financial hub, while maintaining the integrity of the tax base.

The CFC regime will be modernised to more adequately handle the current international environment and key CFC reforms will include:

- The repeal of the existing FIF rules, thereby retaining a revised set of CFC rules (to be rewritten into the *Income Tax Assessment Act 1997*) as the primary set of rules aimed at offshore tax deferral arrangements.
- The extension of the CFC rules to cover closely-held fixed trusts and non-common law entities that confer ownership rights.
- The introduction of a specific exemption for complying superannuation funds.
- Retention of the current legal-based approach to defining passive income but a commitment to undertake further consideration of the active/passive income dichotomy. This will include an update of the concept of a 'financial intermediary business' and the treatment of rent or royalties where the taxpayer's activities are truly active.
- Allowing a group approach to the application of the active income test, which logically should flow through to determine attribution where this test is failed, but this point is currently unclear. A group will include all entities that are consolidated for accounting purposes or equity accounted.
- Expansion of the methods to calculate CFC attributable income so that the new CFC rules will provide the following optional methods:
 - branch equivalent method – as currently available
 - market value method - previously available only under FIF regime
 - deemed rate of return method - previously available only under FIF regime.
- As part of the simplification of the branch equivalent method, the base company income rules will be removed thus simplifying the calculations and reducing compliance costs.
- Section 404 will be repealed bringing the taxation of dividends received by CFCs into line with dividends received by Australian companies.
- The government did not accept the Board recommendation to exempt public companies satisfying relevant criteria such as a comparable worldwide effective tax rate or sufficient distributions rule.

Non-CFC amendments will include:

- Expansion of the exemption for non-portfolio dividends from simply covering voting interests to incorporate other equity-like features such as capital, rights to dividends and return of capital. This will effectively harmonise the eligibility for the dividend exemption with the requirements for calculating a CFC interest.
- The transferor trust rules will remain in force, however a number of modifications have been announced, including:
 - removal of the control test in relation to the pre-commencement and pre-resident transfers
 - attributable income in relation to an eligible transferor will be apportioned based on the proportion of the transfer.
- Various targeted integrity measures will be implemented, including specific anti-roll-up fund measures e.g. funds created to convert revenue income into capital gains hence reducing the incidence of tax.

Off-market share buy-backs

The government also announced its response to the Board's review of share buy-backs, confirming that it will implement the recommendations contained within the Board's report, which has now been released to the public.

Significant announced changes which will take effect from Royal Assent to the amending legislation include:

- Endorsement of the Board's recommendation to remove the Australian Taxation Office's (ATO) administrative limit on the discount to market value for off-market share buy-backs by listed companies (over which the ATO denies franking credits to shareholders). Currently, the ATO denies franking credits if such buy-backs take place at a discount of greater than 14 percent of market value. The announcement does not cover unlisted companies. This should allow the price for tender buy-backs to be set without the possibility of a denial of franking credits to shareholders.
- Balancing the above concession, legislation will be introduced to deny capital or revenue losses arising to shareholders on the disposal of their shares in an off-market buy-back by a listed company (unless the total buy-back proceeds are less than cost base). Such losses arise due to the reduction in sale consideration by the deemed dividend component but are already denied to shareholders that are companies if the proceeds exceed cost base. This announced change also does not affect unlisted companies.
- Legislation will also be introduced to debit the franking account of a company that undertakes an off-market share buy-back where a tax benefit arises due to the streaming of imputation credits from non-resident to resident shareholders. This mirrors existing ATO practice but no details have been released on whether the franking debit will be calculated on the same basis as currently applied by the ATO.
- Legislation will codify the ATO's existing administrative practice in determining the capital/dividend split of a share buy-back and confirm that certain integrity provisions will not apply to tender style off-market share buy-backs by listed companies (they will continue to apply to unlisted company buy-backs). The Board's report also recommends further ATO guidance and the issue of rulings on a number of aspects surrounding share buy-backs. These changes should provide greater information to taxpayers and simplify the process of obtaining a ruling from the ATO on a share buy-back.

Life insurance companies – exempt annuity business

The government announced that consultation will be undertaken to clarify the scope of the exempt annuity business of life insurance companies.

Other relevant business tax measures previously announced or enacted

The following previously announced measures remain relevant in considering the forthcoming impact of tax changes for business taxpayers:

- The long awaited legislation to enact the raft of tax consolidation announcements made since 2005 has now been released as an exposure draft for submissions and consultation.
- TOFA stages 3 & 4, finally enacted in March 2009, will govern the tax-timing treatment of financial arrangements with effect from 1 July 2010, with taxpayers having the choice to early adopt from 1 July 2009.

Indirect taxation

New GST announcements

Government response to Board of Taxation report into GST

The government also responded to the Board's review of the legal framework for the administration of GST, which encompassed an initial issues paper in July 2008 and additional summaries of key issues in August 2008. The government has agreed to implement almost all of the Board's recommendations.

Although most of the recommendations with substantial changes to the GST law will apply from 1 July 2010, significantly, a proposal to limit the availability of input tax credits to four years took effect from 7:30pm on 12 May 2009.

Some of the key areas in which the government has supported change include:

- Removing the GST-free concessions for the supply of going concerns and farmland and replacing them with a reverse charge mechanism which is to be available for a wider range of supplies than going concerns.
- Allowing adjustments where there is a 'manufacturers' rebate' such that the GST paid will reflect the economic outcomes of the transaction.
- Bringing the GST law, including the rulings, amendments and refunds systems, in line with the income tax self-assessment regime and rulings regime.
- Simplifying the GST grouping membership rules by replacing the detailed rules with principle-based rules. In particular holding companies will be entitled to register and group for GST purposes, despite not carrying on an enterprise. However, they will not be entitled to continue to be registered once they leave the group, unless at that time they are carrying on an enterprise.
- Allowing entities to self-assess their eligibility to form, alter and revoke a GST group or GST joint venture, and to form, alter and revoke a GST group or GST joint venture at any time during a tax period, and clean exit rules will be introduced to allow entities to leave GST groups or GST joint ventures clear of any GST consequences.
- Simplifying the GST adjustment provisions, including amendment of the GST change of use provisions, to provide higher thresholds, fewer and shorter adjustment periods and greater alignment with other adjustment rules. In addition, adjustments for private use would be explicitly aligned with the percentage of private use for income tax purposes and adjustments for change of use arising from input taxed use would only occur where the change in use is significant.

- An option to tax business to business (B2B) supplies to ensure that, where it is not possible to know at the time of entering into a supply the extent to which it is taxable, registered parties will be allowed to agree to treat the transaction as fully taxable. This will not apply to a supply where a part or all of it is an input taxed supply.

In accordance with other recommendations made by the Board, the government has also announced the following separate reviews:

- The government has asked the Board to undertake a review of the application of the GST to cross-border transactions to ensure they are treated in an efficient and effective manner.
- Treasury will also undertake reviews of the GST margin scheme and the application of GST to financial supplies, both of which are designed to simplify the operation of the legislation and reduce compliance and administrative costs whilst retaining the existing policy intent.

To assist with the implementation of the measures, Treasury has released public discussion papers for consultation which also provide implementation information on a number of the measures.

The agreement of the states and territories will be required to implement some of the announced changes.

GST and cross-border transport supplies

The GST law will be amended with effect from 1 July 2010 to reduce GST compliance costs associated with the domestic transport component associated with the export and import of goods. The government will:

- For imports, add the cost of domestic transport into the value used for calculating the GST liability on importation, thus shifting the burden of GST away from the transport service supplier (whose supply will not be subject to GST) and onto the importer.
- For exports, treat the 'place of export' as being the place from which the goods are sent, rather than the point of containerisation (to ensure consistency with postal goods), and treat sub-contracted domestic transport services that are part of a domestic leg of an international export of goods as being subject to GST.

Previously, the ATO had issued rulings which effectively required suppliers to separately identify, and pay GST on, the domestic component of any international transportation of goods arising prior to the place of containerisation. This caused confusion and increased compliance costs, particularly for transport suppliers. Treasury will release a discussion paper for public consultation in relation to the design of the new measures.

Previously announced GST measures

GST treatment of Carbon Pollution Reduction Scheme (CPRS) units

The GST law will be amended to ensure that CPRS units will be treated as personal property rights and not real property rights for GST purposes. This is intended to ensure that the trading of CPRS units can potentially be GST-free (when exported), and overcome the need for offshore suppliers to register for GST by reason of the sale of CPRS units.

GST liabilities on insolvency

In response to the Federal Court of Australia's decision in a GST test case, *DCT v PM Developments Pty Ltd* [2008] FCA 1886, the government has announced the GST law will be amended (with retrospective effect to 1 July 2000) to ensure that representatives of incapacitated entities (e.g. administrators and liquidators) remain liable for GST when selling the assets of those insolvent entities.

In other words, the representative will stand in the shoes of the insolvent entity and the sale will attract the same GST consequences that would have applied had the insolvent entity made the sale. The amendment is intended to restore the original policy intent underlying Division 147 of the *GST Act*.

Customs and excise

Enhanced Project By-law Scheme (EPBS) – Customs concessions for imported capital equipment

The EPBS currently provides customs duty concessions for imported capital equipment for major projects that demonstrate Australian industry has had full, fair and reasonable access to participate in such projects.

In its publication, *Powering Ideas – An Innovation Agenda for the 21st Century*, the government foreshadows a revamp of the existing provisions of the EPBS to ensure that Australian industry has full access to private sector tenders.

Whilst the details of the 're-energising of existing mechanisms' have yet to be published, the announcement signifies a tightening of the Australian Industry Participation Plan and subsequent evidentiary requirements to gain access to customs import duty concessions for major projects.

Alcohol related measures

The Budget also confirmed previous announcements made by the government in respect of increased rates of excise and customs duties applicable to 'other excisable beverages' (or ready to drink beverages) from midnight on 26 April 2008.

The rates of excise and customs duties applying to these products are \$66.67 per litre of alcohol from midnight 26 April 2008 to 31 July 2008; \$68.54 per litre of alcohol from 1 August 2008 until 1 February 2009 and \$69.16 per litre of alcohol from 2 February 2009. The *Excise Tariff Validation Bill 2009* and *Customs Tariff Validation Bill 2009* were introduced into the House of Representatives by the Minister for Health and Ageing on 12 May 2009. These Bills, if enacted, will validate retrospectively to 26 April 2008 the collection of excise and customs duties at the rates referred to above.

The Budget papers also confirmed that excise and customs duty of \$69.16 per litre of alcohol will continue to apply to these products from 14 May 2009 and will be subject to normal indexation arrangements thereafter. *Customs Tariff Proposal (No.3) 2009* and *Excise Tariff Proposal (No.1) 2009* were introduced into the House of Representatives by the Minister for Health and Ageing on 12 May 2009, to give effect to this duty rate, pending the introduction into the parliament of excise and customs tariff amendment bills.

As previously announced, the government will also alter the taxation definitions of beer and wine from 1 July 2009 to ensure that beer and wine based products that attempt to mimic spirit based products are taxed as a spirit product.

The definition of beer will include a 'sufficient bitterness' requirement, and will clarify that the addition of sugar, artificial sweeteners and spirits may result in the resultant product being taxed as a spirit-based product. The definition of grape wine products will exclude those that add the flavour of any alcoholic beverage, other than wine. Other changes to the definition of grape wine products will provide certainty as to the circumstances where alcohol can be added to a grape wine product.

Innovation and climate change

Research & Development incentives

The government has outlined its 10-year innovation agenda for Australia in *Powering Ideas: An Innovation Agenda for the 21st Century* which is supported by a proposed \$3.1 billion boost in funding over the next four years. The Budget package announced a major overhaul of tax arrangements and introduced targeted assistance.

Broadly, from 2010-11 the following two-tiered R&D credit or offset will replace the existing R&D tax concession system:

- A 45 percent refundable tax credit for Australian companies turning over up to \$20 million per annum (equal to 15 cents in the dollar of R&D spend). Eligible companies with tax losses will be able to 'cash out' the R&D credit when lodging their income tax return and there will be no cap on the amount of R&D expenditure subject to the R&D credit. This could make Australia an attractive destination for R&D intensive start-ups. The government includes biotechnology and information and communication technologies as targets for the R&D refundable credit.
- Large companies or corporate groups with an annual turnover in excess of \$20 million, and those that are majority foreign owned, will receive a 40 percent R&D tax credit rather than tax deductions (equal to 10 cents in the dollar of R&D spend).

Proposed tightened eligibility criteria

Subject to a consultation process, tightened eligibility criteria will apply to ensure that only genuine R&D receives support; in particular, large-scale claims may be targeted. The government proposes to release a consultation paper during 2009 to provide a framework to define the scope of R&D activity.

KPMG will work with industry bodies to frame an appropriate R&D credit system that achieves the targeted policy objectives without compromising the capacity of Australian companies to innovate, and will seek input to provide the government with relevant commercial perspectives.

Replacement of R&D tax concession systems

The Budget announced the abolition from 2010-11 of both the R&D tax concession scheme (allowing a 125 percent deduction for all R&D that equates to a tax saving of 7.5 cents in the dollar) and the additional R&D deduction of 50 percent for incremental R&D (known as the 175 percent premium tax concession which provided a tax saving of up to 22.5 cents in the dollar).

The R&D cash offset allows small companies with less than \$5 million turnover to cash out their R&D deduction. For the 2009-10 year of income the R&D expenditure cap will be doubled to \$2 million and the proposed R&D credit will then replace the R&D cash offset.

R&D carried out on behalf of foreign related companies

The international premium tax concession (which provided a 4.5 cents in the R&D dollar saving in the 2008 income year) will be replaced by the 40 percent R&D credit providing 10 cents in the R&D dollar cash saving.

The transition date is undecided but is likely to be the first year of income commencing after 1 July 2010. For example a company with a substituted accounting period of 31 December 2010 (an 'early balancer date' company) might apply for the new R&D credit for expenditure incurred after 1 January 2011.

R&D tax planning issues

In budgeting for R&D expenditure, companies which may benefit from the proposed higher R&D credit rates may defer R&D spending until 2010-11, whereas companies currently eligible for the 175 percent premium R&D tax concession may wish to accelerate their R&D spend. Companies will need to carefully monitor their R&D time-lines, pursuant to company approved R&D plans.

The design of the new R&D credit as a tax offset should resolve the problem created by the existing R&D tax concession system which, by reducing taxable income and the associated tax liability, potentially results in reduced franking credits and can hence limit the frankable dividends that can be paid to shareholders.

Tax loss companies with an annual turnover in excess of \$20 million will not be able to cash out their R&D credits but they will be recoverable against future taxable income, although there may also be issues interacting with any foreign tax credits or offsets.

The current tax law contains anti-avoidance provisions relating to companies carrying out R&D under contracts whereby companies are denied deductions if they are not at financial risk and do not own the R&D results. KPMG will lobby to retain the integrity of these provisions, and to limit unintended consequences to ensure the new R&D credit system is transparent, predictable and equitable for companies carrying out R&D under contract.

Other government funding for science and innovation

Whilst there is no direct replacement for the Commercial Ready program which the government abolished in last years budget, the government is continuing to support innovation in a wide range of targeted direct grant assistance programs and support for collaborative research between business and universities.

Additional details on these programs are likely to be released by the government in the near future.

Australian Government climate change strategy

As part of its climate change strategy, the government has introduced a comprehensive range of climate change measures to ensure that Australia adapts appropriately to the impacts of climate change, has the necessary framework to support the transition to a low pollution future and plays an active role in shaping a strong global solution/response to climate change.

The previously announced CPRS, released as draft legislation on 10 March 2009 as the CPRS Bill 2009 and a package of supporting Bills, is the key driver in Australia's strategic response to climate change. The package of Bills includes detailed provisions relating to the proposed GST and income tax treatment of Australian registered emissions units created under the CPRS.

Initially expected to start in 2010, the government announced on 4 May 2009 a deferred start date of the CPRS by one year to 1 July 2011 and made a new commitment to reducing Australia's carbon pollution to 25 percent below 2000 levels by 2020. While the new start date for the CPRS will give business additional preparation time, business should continue to prepare for the introduction of CPRS. The extra time which the government's deferral offers should not be wasted given the significant challenges involved in preparing for the 2011 start and to meet the substantial emissions reduction targets under the CPRS.

To support both the CPRS targets and the Renewable Energy Target, the government has announced in this Budget that it will invest \$4.5 billion in the Clean Energy Initiative. Through this initiative, the government will support the growth of clean energy generation and new technologies, reduce carbon emissions and create low pollution jobs by:

- Investing \$2.4 billion in low emissions coal technologies, including new funding supporting industrial-scale carbon capture and storage projects.
- Investing \$1.365 billion in a Solar Flagships program increasing Australia's solar generation capacity.
- Establishing Renewables Australia, a new body to support the development, commercialisation and deployment of leading edge renewable energy technologies.

The government is also driving investment in renewable energy, carbon capture and storage, and action on energy efficiency through the Climate Change Action Fund, providing \$2.75 billion in support of businesses, industry and community organisations.

The government will also establish the Australian Carbon Trust to help all Australians, including individual households, to do their bit to reduce Australia's carbon pollution, to drive energy efficiency and to ensure individual efforts to reduce emissions are taken into account under the CPRS. For example, a \$25.8 million Energy Efficiency Savings Pledge Fund (Pledge Fund) will be set up to enable individuals and households to simply calculate their energy use and buy and retire carbon pollution permits under the CPRS. Contributions to the Pledge Fund will be voluntary and tax deductible.

In addition, the government will invest \$16.1 million over 4 years to develop a National Carbon Accounting Toolbox as a cost-effective, nationally-consistent emissions estimations tool for forestry and agriculture.

Miscellaneous tax issues

Fixed trust CGT rollover relief

As a result of the proposed removal of the trust cloning measures, with effect from 1 November 2008 the government will remove the incidence of a CGT taxing point on the transfer of assets between fixed trusts (typically trusts with the same beneficiaries with the same entitlements and no material discretionary elements). A limited rollover relief will be introduced for such trusts, allowing the trustees to defer the CGT consequences of the asset transfer until the receiving trust subsequently deals with the asset, providing the opportunity for eligible trusts to restructure without adverse immediate CGT consequences.

Extension of TFN withholding rules to closely held trusts

To ensure that assessable distributions to beneficiaries of a closely held trust (generally one with fewer than 20 beneficiaries) align with the amounts included in their tax returns, the government has announced that the tax file number (TFN) withholding arrangements will be extended to such trusts with effect from 1 July 2010. The changes will require such trusts to withhold amounts at the top marginal rates where taxpayers have not provided their TFN to the trustee.

Charities

The High Court recently found in favour of the taxpayer in the case of *FCT v Word Investments Ltd* [2008] HCA 55 where one of the key issues was whether an entity may have charitable status for tax purposes, notwithstanding that it carries out commercial activities so as to derive a profit for distribution to other charities. The High Court effectively held it was a false dichotomy to distinguish between the commercial means used to derive income and the charitable objects to which that income is then applied.

The government has indicated it will await the outcome of the *AFTS Review* and the Productivity Commission's inquiry into the not-for-profit sector before responding to the High Court's decision. However, it has asked Treasury and the ATO to monitor the sector and advise if any adverse implications arise. This will be an important issue for some charities given the increasingly sophisticated means used to derive income to pursue their charitable objectives.

ATO strategic compliance package

The government will provide \$595.2 million over 4 years to fund a number of strategic compliance measures, including tackling revenue risks and providing support for small businesses and other taxpayers experiencing difficulties in meeting their tax liabilities in the current economic climate. Over half of the package will be spent on targeting wealthy Australians and large and medium sized businesses. A new Small Business Support Line and referral service will be established to assist small businesses affected by the global financial crisis.

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