TAXWISE
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The 2013-14 Federal Budget

The 2013-14 Federal Budget was handed down on 14 May 2013. The Budget was fairly moderate and, like the 2012-13 Budget, is designed to set a pathway towards a surplus in the future.

The main focus of the Budget is to **protect the corporate tax base** from international profit-shifting and erosion, **close certain loopholes** and **better target certain tax concessions**. However, there are changes that affect everyone.

Below is a summary of the most significant measures announced in the Budget. To make sure you get the most specific advice for your circumstances, particularly where you believe a Budget measure might affect you, it is essential you consult your tax adviser.

Tax changes affecting Individuals and Families

Change to Medicare levy low income thresholds from 1 July 2012

Starting from 1 July 2012:

- The Medicare levy low income threshold for the 2012/13 income year will increase to $20,542 for individuals, and $32,279 for pensioners eligible for the Seniors and Pensioners Tax Offset.
- The Medicare levy low income threshold for families for the 2012/13 income year will increase to $33,693, and the additional family threshold amount for each dependent child or student will increase to $3,094.

Changes to HECS-HELP

From 1 January 2014, the following changes to HECS-HELP program will cease to be available:

- the 10% discount for upfront payments;
- the 5% bonus on voluntary payments made to the Australian Tax Office of $500 or more to voluntarily reduce HECS-HELP debt.

Phase out of net medical expenses tax offset

The net medical expenses tax offset (NMETO) will be phased out with transitional arrangements applying to those who currently claim the offset.

- Taxpayers who claimed the NMETO in the current year (2012-13) will be able to continue to claim the offset in the 2013-14 income year if they have eligible out-of-pocket medical expenses above the relevant thresholds.
- Taxpayers who are eligible to claim in the 2013-14 year can continue to do so in the 2014-15 year.
- Until 1 July 2019, the NMETO will continue to be available for certain out-of-pocket medical expenses (disability aids, attendant care or aged care expenses) when *DisabilityCare Australia* is to become fully operational and aged care reforms have been in place for several years.

The end of the Baby Bonus and new family payment arrangements

The Baby Bonus will cease to be available from 1 March 2014. Instead:

- Family Tax Benefit (**FTB**) Part A will be increased $2,000, to be paid in the year following the birth or adoption of a first child or each child in multiple births, and $1,000 for second and subsequent children. The additional FTB Part A will be paid as an initial payment of $500, with the remainder to be paid in seven fortnightly instalments.
- Parents who take up Paid Parental Leave (**PPL**) will not be eligible for the additional FTB Part A component. However, the work test under the PPL scheme will be extended so that parents will be able to count periods of government PPL as "work", similar to employer-funded PPL.

Deferral of increase in tax-free threshold

As part of the Clean Energy Future Package, the carbon price is projected to fall from $25.40 in 2014/15 to $12.10 in 2015/16. Further income tax cuts that had previously been legislated, in the form of a further increase in the tax-free threshold from 1 July 2015 will be deferred.

Certain disaster payments to be exempt from income tax

Disaster Income Recovery Subsidy (DIRS) payments provided to eligible persons, to provide financial assistance to employees, small business persons and farmers who experience a loss of income as a direct consequence of a natural disaster occurring in Australia between 3 January 2013 and 30 September 2013 will be exempt from income tax. This will affect the 2012-13 and 2013-14 income years.

Capping of work-related self-education expense deductions

From 1 July 2014, a cap of $2,000 will be imposed on work-related education expenses incurred by individuals. Deductible expenses include costs of courses of study or other education activity (such as conferences and workshops) including tuition fees, registration fees, textbooks and professional and trade journals.

Tax changes affecting companies and finance arrangements

Tax consolidation regime loopholes to be closed

Following on from Board of Taxation recommendations, certain loopholes will be closed in the tax consolidation regime. The measures will affect transactions taking place after 14 May 2013 (and the amendments concerning intra-group liabilities and assets subject to the TOFA regime will only apply to income tax returns and requests for amended assessments lodged from 14 May 2013). The measures address loopholes where "double deductions" have been able to be claimed and include:

- Limiting the application of the tax cost setting rules for membership interests in an entity transferred to a consolidated group which are not taxable Australian property under the non-resident CGT rules (non-residents will not be able to buy and sell assets between consolidated groups). The cost setting rules will only apply if:
  1. there has been a change in the underlying majority beneficial ownership of the membership interests in the entity, or
  2. there has been no change in the underlying majority beneficial ownership of the membership interests in the entity, but the interests were recently acquired (less than 12 months) by the foreign entity or group.
- Preventing deductible liabilities being taken into account twice where consolidated groups purchase entities with deductible liabilities. The purchaser group will be deemed to have received or paid an amount equal to the value of the joining entity's non-TOFA deductible liabilities that were taken into account for tax cost setting purposes, either increasing or decreasing the head company's assessable income (to the extent the liability will either give rise to a deduction or an assessable amount).
- Preventing access to double deductions where the value of assets is shifted between member entities. The tax cost setting rules will be amended such that an asset created by transferring the value of an existing asset to a subsidiary is given a cost base that reflects the notional cost of creating the asset, rather than the market value of the newly created asset.

Amendments will also be introduced to ensure that when an entity leaves a consolidated group, only net gains and losses are recognised for certain intra-group liabilities and assets (between the leaving entity and remaining members) which become subject to the TOFA regime upon leaving.

Removing "dividend washing" opportunities

With effect from 1 July 2013, measures will be introduced to ensure that sophisticated investors will not be able to engage in "dividend washing". Dividend washing allows an investor to claim two sets of franking credits on effectively the same parcel of shares. Changes to the 45 day holding rule and “last-in first-out” rules will be considered during consultation with business on this issue. Investors with franking credit tax offset entitlements of more than $5,000 will be affected.

Prevention of profit shifting using Australian debt – changes to the thin capitalisation rules

To assist in the prevention of profit-shifting, the following measures amending the thin capitalisation rules will be brought in:

- The safe harbour limit for general entities will be reduced from 3:1 to 1.5:1 on a debt to equity basis;
- The safe harbour limit for non-bank financial entities will be reduced from 20:1 to 15:1 on a debt to equity basis;
- The capital limit for banks will be increased from 4% to 6% of risk weighted assets of Australian operations;
- The worldwide gearing ratio will be reduced from 120% to 100% for outbound investors (with an equivalent change to the worldwide capital ratio for banks);
- The worldwide gearing test will be extended to inbound investors and
- The *de minimis* threshold will be increased from $250,000 to $2 million of debt deductions.

The Board of Taxation will also consider ways to improve the operation of the arm's length test.

Various International Tax measures

1) Foreign non-portfolio equity interests

From 1 July 2014, the exemption available to Australian companies for foreign non-portfolio dividend income (the interest holding is >10% of equity interests in the foreign entities) will be amended (as previously announced in the 2009-10 Budget) to ensure that:

- the exemption operates as intended and is not available to returns on debt interests or interests that are in fact portfolio (<10%) in nature; and
- the exemption will also apply where the foreign non-portfolio dividend income is received through an investment in a trust or partnership.

2) Interest incurred in deriving foreign exempt income

From 1 July 2014, the tax deduction for interest expenses incurred in deriving certain foreign exempt income will be removed.

3) CFC rules

The reforms to the controlled foreign company (CFC) rules and foreign source income attribution rules previously announced in the 2009/10 Budget will be reconsidered after the Organisation of Economic Co-operation and Development (OECD) completes its analysis on base erosion and profit shifting.

Other measures

- Certain loopholes in the current Offshore Banking Unit regime will be closed off from 1 July 2013.
- The immediate deduction for the cost of assets first used for exploration will be amended to mining rights and information. This impacts taxpayers who start to hold mining rights or information from 7.30pm (AEST) on 14 May 2013 unless the taxpayer has committed to acquire the mining right or information before that time or are taken by tax law to already hold the right or information before that time.

Capital Gains Tax changes

CGT and Non-residents – further changes

Further to the changes already being made to how capital gains tax (**CGT**) applies to non-residents, in addition, the principal asset test will be amended. The amendments will ensure that indirect Australian real interests are taxable if disposed of by a non-resident. In particular, the amendments will involve:

- removing the ability to use transactions between members of the same tax consolidated group to create and duplicate assets, ensuring that assets cannot in effect be counted multiple times, thereby diluting the true asset of the group;

- in determining the value of the Taxable Australian Real Property (**TARP**) assets of the entity in which the interest is held, intangible assets connected to the rights to mine, quarry or prospect for natural resources (notably mining, quarrying or prospecting information, rights to such information and goodwill) will be treated as part of the rights to which they relate.

The amendments will apply to CGT events occurring from 7.30pm (AEST) 14 May 2013.

A 10% non-final withholding tax will also be introduced to apply to disposals of certain taxable Australian property by non-residents. Residential property transactions under the value of $2.5 million or disposals by Australian residents will not be affected. A purchaser will be required to withhold and remit to the Australian Taxation Office 10% of the proceeds from the sale.

This will affect transactions from 1 July 2016.

CGT and native title benefits

The CGT treatment of native title benefits has been clarified such that, from 1 July 2008, there will be no CGT implications arising from the transfer of native title rights (or the right to a native title benefit) to an Indigenous holding entity or Indigenous person, or from the creation of a trust that is an Indigenous holding entity over such rights. Capital gains or losses made from surrendering or cancelling such rights will also be disregarded.

Superannuation changes

Reduction of higher tax concession for superannuation contributions of very high income earners

With effect from 1 July 2012, minor amendments will be made to the 2012/13 Budget measure to reduce the higher tax concession for superannuation contributions of very high income earners (greater than $300,000). These minor amendments involve:

- an exemption for employer contributions for certain Federal judges and employer contributions made to constitutionally protected funds for certain State higher level office holders;
- using a similar definition of income for the measure to that used for calculating whether an individual is liable to pay the Medicare levy surcharge; and
- refunds to former temporary residents of the tax paid under the measure because they do not receive any concessional tax treatment on their super contributions due to other rules which affect them.

Reforms to excess contributions tax

From 1 July 2013, the excess contributions tax system will be amended to ensure excess concessional contributions will be taxed at an individual's marginal income rate. There will also be an interest charge to recognise that the tax on the excess contribution is being collected later than normal income tax. Individuals will also be allowed to withdraw any excess concessional contributions from their super fund.

Higher concessional contributions cap

The concessional contributions cap will be increased from $25,000 to $35,000 from 1 July 2013 for individuals aged 60 and over. Individuals aged 50 and over will be able to access the higher cap from 1 July 2014. Once the general concessional cap reaches $35,000 through indexation, which is anticipated to be by 1 July 2018, this higher cap will be available to all individuals.

Low income superannuation contribution

Where an individual has an entitlement for the low income superannuation contribution that is below $20, the entitlements will now be paid. Entitlements below $10 will be rounded up to $10 and paid as well. This will impact individuals with incomes of up to $37,000.

Tax Administration Changes – Various funding to the Australian Taxation Office

Trusts and Tax Avoidance

The Budget provides for $67.9 million to be provided to the Australian Taxation Office over 4 years to form a Task Force to undertake compliance activity in relation to taxpayers who have been involved in egregious tax avoidance and evasion using trust structures.

The Task Force is to target the exploitation of trusts where trusts may have been used to conceal income, mischaracterise transactions, artificially reduce trust income amounts and underpay tax. The Task Force will focus on known tax scheme designers and promoters, and individuals and businesses who participate in these arrangements.

This measure is estimated to increase revenue by $379m over the forward estimates period.

Extension of monthly PAYG instalments to other large entities

The previously announced proposal to apply the Pay As You Go (**PAYG**) instalment system to large companies requiring them to make monthly instalment payments will be extended out to all large entities including trusts, superannuation funds, sole traders and large investors. This will apply to all entities in the PAYG system with turnover of $1 billion or more from 1 January 2016 and all entities with turnover of $20 million or more from 1 January 2017.

No change has been made to the original proposal that affects companies which remains as:

- companies with turnover of more than $1 billion to move to monthly PAYG instalments from 1 January 2014;
- companies with turnover of $100 million or more to move to monthly PAYG instalments from 1 January 2015; and
- companies with turnover of $20m or more to move to monthly PAYG instalments from 1 January 2016.

Some exceptions apply for certain entities other than head companies with a turnover of less than $100 million. There are modifications for entities who are in the taxation of financial arrangements regime.

Increased compliance checks on offshore marketing hubs and business restructures

The Australian Taxation Office will also be provided with $109.1 million over four years to increase its compliance activity targeted at restructuring activity that facilitates profit shifting opportunities.

Expanding data matching with third party information

The Australian Taxation Office will be provided with $77.8m over four years to improve compliance by expanding its data matching activities using third party information.

The measure will establish new and strengthen existing reporting systems for:

- taxable government grants and specified other government payments;
- sales of real property, shares (including options and warrants), and units in managed funds;
- sales through merchant debit and credit services;
- managed investment trust and partnership distributions, company dividend and interest payments; and
- transactions reported to the Tax Office by the Australian Transaction Reports and Analysis Centre.

This measure is estimated to have a gain to revenue of $610.2m over the forward estimates period.

The information provided to the Tax Office will also improve the pre-filling of tax returns.

Enhancements to Standard Business Reporting, Australian Business Register and ABN administration

The Australian Taxation Office and Department of Finance and Deregulation will receive $80.2 million over the forward estimates period to strengthen up-front checks for issuing Australian Business Numbers and encourage the use of AUSkey, which is a secure credential for accessing the online services of the Australian Business Register. This measure will also enhance Standard Business Reporting to continue to reduce compliance costs for business.

Other measures

Tax agent services licensing regime

The Australian Securities and Investments Commission (**ASIC**) will receive $1.4 million over four years to provide for a single, online registration for financial advisers registered with the Australian Securities and Investments Commission that also need to register as tax advisers from 30 June 2013. This follows the end of the exemption of financial advisers from the tax agent services licensing regime.

The cost is expected to be offset by the fees charged for financial advisers who are required to register.

Establishment of Tax Studies Institute and Tax System Advisory Board

The Government will establish a Tax Studies Institute (TSI) as a centre for excellence in tax research at the Crawford School of Public Policy at the Australian National University by providing a one-off endowment payment of $3m in 2012/13.

The Government will also establish a Tax System Advisory Board within the Australian Taxation Office to advise the Commissioner of Taxation and ATO Executive Committee on the strategic direction, culture, organisation, management, compliance planning, staff profile and information technology plans at the ATO. The cost of this measure will be met using existing ATO resources.