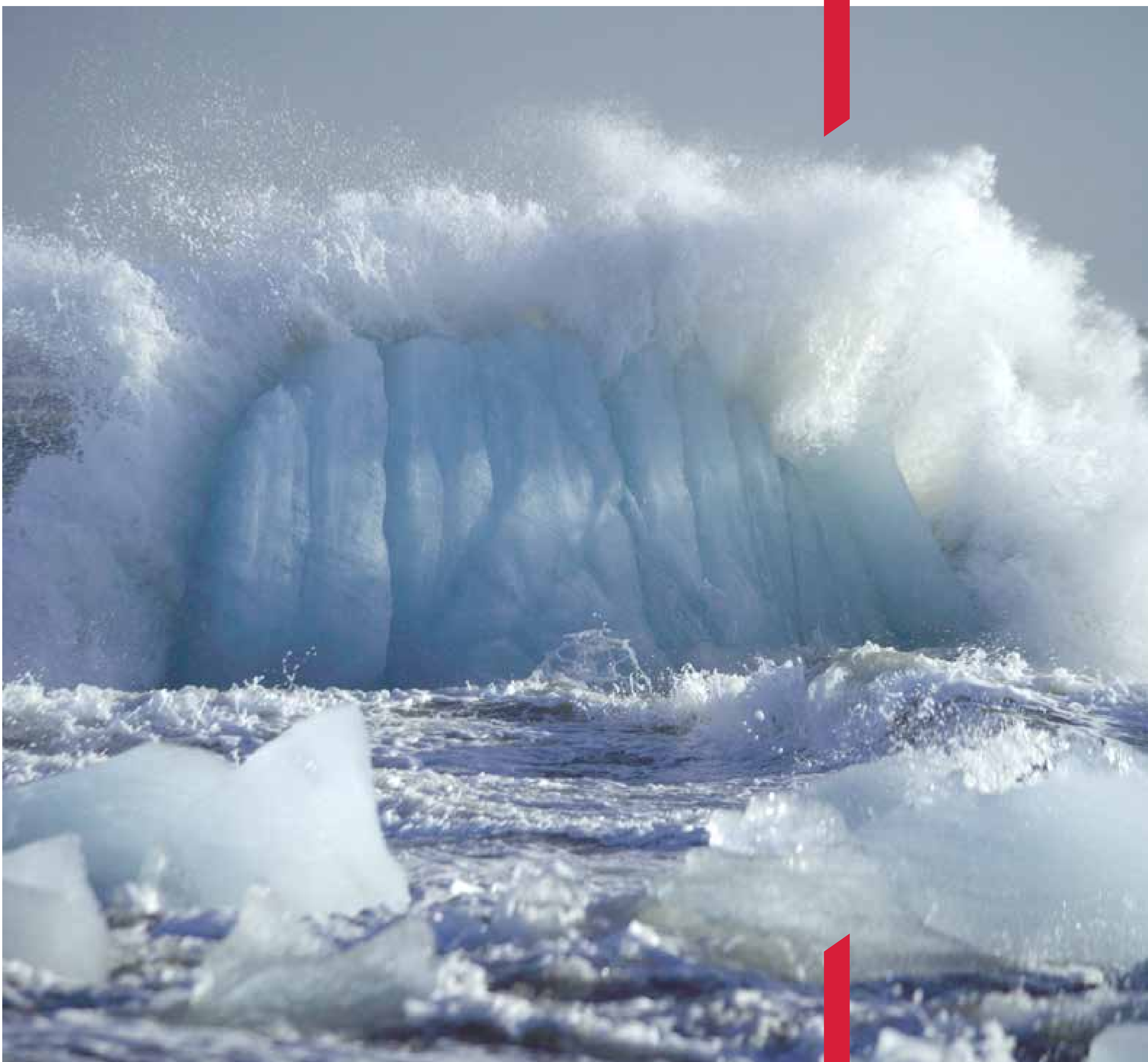
FEDERAL BUDGET 2013

Breaking the Ice



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FEDERAL BUDGET 2013 – THE TIP OF THE ICEBERG!

As expected, the 2013-14 Budget will be cold comfort to Australian businesses who continue to rely on certainty as the key component to good decision making. While the business community wasn't expecting much from what could be Wayne Swan's final Budget, the question is whether continuing to tinker around the edges of tax reform only adds to the danger of what lies beneath the surface.

"There needs to be an end to using the tax system for short term budget fixes."

BDO considers that this Budget will just be the 'tip of the iceberg' in terms of the impact ignoring real tax reform will have on the Australian economy and support for business long term. As long as real reform continues to be ignored – in the same way as the Captain of the Titanic ignored the dangers and perils of what lay beneath the cold Atlantic – Australian business will continue to chart a wary course, potentially stifling real growth and prosperity.

As BDO persists in calling for a more holistic approach to tax reform, we also continue to see elements of remedies previously identified being picked up and used for other purposes. These approaches have the effect of potentially charting a course that could be a full on collision with the dangers that lurk beneath the surface of the ever-growing complexity that is our tax system. There are numerous changes within this Budget, such as the thin capitalisation, exploration amendments, and Research & Development (R&D) measures, that were all previously identified by the Business Tax Working Group in order to fund the previously proposed corporate tax rate cuts, that have now been implemented but without the benefit of the rate cut.

This year's BDO Federal Budget Report has focused on five key categories: Across the board issues, Personal issues, Corporate issues, International issues, and Industry issues.

Trusts, tax compliance and indirect taxes feature prominently for issues across the board. Personal tax rates, the Medicare levy, and work related self-education expenses are the main focus for personal issues. For corporates, the changes to R&D, compliance activity around dividend washing and consolidations are key features, and for international concerns, thin capitalisation is emphasised. Finally, we have put in the spotlight, Natural Resources, Not-For-Profits, and the Environment covering key industry related matters.

Based on the above, BDO considers that this budget, while a revenue raiser, also fixes some technical issues, but really is just further tinkering at the edges of real tax reform? Whichever Government wins the election later this year, a key priority must be to seriously review the tax system and provide Australian businesses with a regime that remedies the problems created over the past two decades. There needs to be an end to using the tax system for short term budget fixes.

In the journey towards the Government's admirable objectives of 'growth and jobs', business is desperately seeking the chartering of a sensible course towards a holistic and simplified tax regime. The continual tinkering with our tax system runs real risks and dangers of colliding with what lies beneath the surface.

PERSONAL

Deferred tax cuts - Deferral of the 2015-16 tax cuts

The Government announced the deferral of the Clean Energy Future personal income tax cuts scheduled to commence on 1 July 2015. From 1 July 2015, the tax free threshold was to increase from $18,200 to $19,400. The deferral is due to revisions in carbon price projections from 2015-16 onwards, which will be much lower than originally forecast. There will be no change to the tax cuts applied from the 2012-13 income year.

The affected tax cuts will be deferred until the estimated carbon price in the Budget reaches above $25.40, which is projected to be by 2018-19.

The current legislated personal tax rates and thresholds for resident individuals (excluding the Medicare levy) are:

FROM 1 JULY 2013 TO 1 JULY 2014		FROM 1 JULY 2015	
Taxable income	Rate	Taxable income	Rate
($)	**(%)**	**($)**	**(%)**
0 – 18,200	0	0 – 18,200	0
18,201 – 37,000	19	18,201 – 37,000	19
37,001 – 80,000	32.5	37,001 – 80,000	33
80,001 – 180,000	37	80,001 – 180,000	37
180,001+	45	180,001+	45

The Budget did not announce any changes to the tax rates for non-residents. Accordingly, the merging of the first two marginal tax rate thresholds into a single threshold (announced and implemented as a result of the 2012-13 Budget) will continue as follows:

FROM 1 JULY 2013 TO 1 JULY 2014		FROM 1 JULY 2015 ONWARDS	
Taxable income	**Rate**	**Taxable income**	**Rate**
($)	**(%)**	**($)**	**(%)**
0 – 80,000	32.5	0 – 80,000	33
80,001 – 180,000	26,000 + 37% of excess over 80,000	80,001 – 180,000	26,400 + 37% of excess over 80,000
180,001+	63,000 + 45% of excess over 180,000	180,001+	63,400 + 45% of excess over 180,000

Medicare levy increase – DisabilityCare Australia

The Government will increase the base Medicare levy by half a percentage point from 1.5 per cent to 2 per cent, from 1 July 2014, to provide funding for DisabilityCare Australia. All revenue raised from increasing the Medicare levy will be dedicated to DisabiltyCare Australia. The revenue raised by the increase in the Medicare levy will be invested in

a new fund, the DisabilityCare Australia Fund (the Fund), to be drawn on for expenditure directly related to DisabilityCare Australia.

The increase in the rate of the Medicare levy will flow through to other aspects of the taxation system, including FBT (increased from 46.5 per cent to 47 per cent), Superannuation Excess Concessional Tax (increased from 31.5 per cent to 32 per cent), and Non-Concessional Contributions Tax (increased from 46.5 per cent to 47 per cent). Exposure Draft legislation to implement this Budget measure has already been released by Treasury for consideration.

Low-income earners will continue to receive relief from the Medicare levy through the low-income thresholds for singles, families, seniors and pensioners. The current exemptions from the Medicare levy will also remain in place.

Medicare Levy low-income threshold

The Government will increase the Medicare levy low-income threshold for families to $33,693 for the 2012-13 income year, with effect from 1 July 2012.

The additional amount of threshold for each dependent child or student will also increase to $3,094. The increase in these thresholds takes into account movements in the Consumer Price Index, and ensures that low-income families are not liable to pay the Medicare levy.

The Government has already increased the Medicare levy low-income thresholds for individuals and pensioners for 2012-13 as part of the Household Assistance Package. The Medicare levy low-income thresholds increased to $20,542 for individuals and $32,279 for pensioners eligible for the Seniors and Pensioners Tax Offset.

Net medical expenses tax offset phase out

From 1 July 2019, taxpayers will no longer be able to claim a tax offset for out-of-pocket medical expenses. All claims from 1 July 2013 will be restricted to eligible taxpayers who incur out-of-pocket medical expenses relating only to disability aids, attendant care, or aged care expenses.

It's now even harder

Historically, eligible taxpayers could claim a Net Medical Expense Tax Offset (NMETO) for certain out-of-pocket medical expenses. This offset will be phased out completely with transitional arrangements available to those currently claiming the offset.

From 1 July 2013, only those who claimed NMETO in 2012-13 will be eligible to claim NMETO in the 2013-14 income year. Similarly, only those who claimed the NMETO in 2013-14 will be able to claim it in the 2014-15 income year. These offsets will apply to all medical expenses.

In addition, the claim for all other taxpayers (ie those who did not claim the NMETO in 2012-13) will be restricted to out-of-pocket medical expenses for disability aids, attendant care, or aged care expenses, which exceed the relevant thresholds. There is no mention of any change to the existing thresholds ($2120 for 2012/13) or the 20 per cent of the expense that can be claimed.

This revenue measure is expected to deliver revenue of $963.5 million over the forward estimates period.

BDO COMMENT

The Government has continued to restrict NMETO in recent times, delivering the final curtain call in this Budget. The phase out of NMETO is a sizeable revenue earner, which may not be expected to deliver significant political backlash because the benefit of this rebate is generally limited to taxpayers with substantial medical expenses.

Work-related self-education expenses limited to $2,000 per year

The Government has confirmed the Treasurer's 13 April 2013 media release, which proposes the introduction of an annual $2,000 cap on the deductibility of work-related self-education expenses from 1 July 2014. Under the current rules, there is no upper limit on the deductibility of self-education expenses. However, the first $250 of self-education expenses is not deductible if the self-education expenses were incurred in respect of a course of education provided by a school, college or university.

What are deductible self-education expenses?

Under the proposed changes, 'deductible education expenses' are costs incurred in undertaking a course of study, or other education activity such as conferences and workshops. It may also include tuition fees, registration fees, student amenity fees, textbooks, professional and trade journals, travel and accommodation expenses, computer expenses, and stationery, where these expenses are incurred in producing the taxpayer's current assessable income.

The introduction of a cap on the self-education expenses is designed to prevent taxpayers making large claims for expenses such as first class airfares, 5-star accommodation, and expensive courses.

Self-education expenses not subject to FBT

Currently, employers are not liable for Fringe Benefits Tax (FBT) for education and training they provide for their employees. The Government has confirmed they will retain the current treatment, whereby employers are not liable to FBT for education and training they provide to their employees unless an employee salary sacrifices to obtain these benefits.

BDO COMMENT

The concern with self-education expenses is that if an employer pays for the self-education expenses of an employee, the benefit will not be subject to FBT. However, taxpayers that are self-employed may be at a disadvantage as their deductions will be subject to the $2,000 cap. This creates an uneven playing field for employees and the self-employed.

In addition, it is not clear from the proposed changes whether the first $250 of the self-education expenses that are currently not deductible will be retained or removed. The Government has advised they will release a discussion paper in late May 2013 which may provide some guidance.

CORPORATE

Government proposes an end to 'dividend washing'

As part of its drive to protect the tax base from erosion and to close loopholes, the Government announced it would act to prevent 'dividend washing' arrangements. These arrangements are alleged to provide a benefit to taxpayers by allowing them to access double franking credits on dividends received.

How does dividend washing work?

In relation to certain publicly listed shares, a market is created that allows shares to be traded cum-dividend (i.e. with dividend rights still attached) in the two days following the day on which the shares go ex-dividend. The price paid for shares in this market is usually very close to the price in the normal ex-dividend market, plus the value of the dividend to be paid on the shares.

A taxpayer who engaged in dividend washing would sell their shares in the ex-dividend market and buy the same number of shares in the cum-dividend market. They would receive two dividends (one from each parcel of shares) with the attached franking credits.

Assuming that the share had an ex-dividend price of $1.00 and a dividend entitlement of $0.10, their cash flows would be as follows:

Dividend received on original shares: $0.10

Sale of original shares in ex-dividend market: $1.00

Acquisition of new shares in cum-dividend market: ($1.10)

Dividend received on new shares: $0.10.

At the end of the arrangement, the taxpayer has a net cash in-flow of $0.10, but assuming the dividend paid was franked, the taxpayer has received two lots of franking credits (amounting to around $0.08 if the dividends are fully franked). This arrangement was of particular interest to taxpayers who were not immediately assessable on the dividends, but who could still benefit from the franking credits. These included superannuation funds in pension mode, individuals with revenue tax losses and charities.

What is the Government proposing to do?

The Budget announcement states that the Government will only allow the taxpayer a franking credit in relation to one of the dividends received under dividend washing arrangements, with effect from 1 July 2013.

BDO COMMENT

Dividend washing schemes did have the effect of impairing the integrity of the franking system. Therefore, the Government's move to act against them is appropriate. However, it is our view that the existing anti-avoidance legislation available to the Australian Taxation Office was appropriate for the task. This appears to be another case of the regulation applied to taxpayers being increased, when judicious use of the existing law could have prevented the need for further pages of legislation. Clients should be wary of entering into such arrangements.

Research & Development Tax incentive

'Targeting' of incentive, confirmed

The previously announced exclusion from the Research & Development (R&D) Tax Incentive, of companies with Australian turnover over $20 billion, was confirmed in the Budget papers. The benefit to the revenue from tightening access to the Incentive will not kick in until the 2014-15 year with projected annual additional revenue in the order of $350 million per year.

BDO COMMENT

This knee-jerk reaction to fund the Government's 'A Plan for Australian Jobs', announced in February 2013, is inconsistent with the two fundamental requirements of good industry policy, being stability and certainty.

Costings released for new quarterly advance R&D Tax incentive payments

The costs for the introduction of advance quarterly payments of refundable R&D Tax Incentive Credits, as previously announced, was included in the Budget papers. The quarterly advance refundable credits will commence in respect of the period commencing 1 January 2014, and provide for a cash-flow timing benefit to companies entitled to receive the R&D Tax Incentive refundable credits. The implementation is estimated to have a timing impact on the revenue of $270 million, with the future implementation cost for the ATO to implement the measure being approximately $7 million over the next four years.

BDO COMMENT

This measure will be a very useful cash-flow timing assistance measure for cash strapped technology companies.

Tax consolidation integrity measures

The Budget has identified five areas in the tax consolidation regime that requirement amendment. Each of these amendments address integrity issues with the current regime.

Three of the five areas identified in the Budget are recommendations that have been adopted from the June 2012 and April 2013 Board of Taxation papers to fix the following:

- Preventing an uplift in the cost base of Australian assets without recognising a capital gain
- Ensuring that consolidated groups do not access double deductions by shifting the value of assets between entities
- Ensuring that certain deductible liabilities are not taken into account twice in the ACA process.

The remaining two areas that were identified required further consultation in order to implement the announcement. The two areas relate to:

- The interaction between the TOFA regime and the 'exit' of a subsidiary of a tax consolidated group where a liability/asset results in the net gain/loss is recognised
- Aligning the treatment of MEC groups to domestic tax consolidated groups so that the MEC is not able to access certain tax advantages that are not available to a domestic tax consolidated group.

Prevention of cost base uplift

As previously discussed in a Board of Taxation Paper titled 'Post Implementation Review Into Certain Aspects of The Consolidation Regime', there can be an inappropriate uplift in the cost base of assets where a foreign resident disposes of their shares in Australian companies that are non-taxable Australian property asset and the purchaser is an indirectly owned Australian tax consolidated group. This currently allow the new Australian tax consolidated group to, in some circumstances, increase the cost base of the underlying assets of the new subsidiary of the consolidated group. This proposed amendment is intended to correct this anomaly by only allowing a step up in cost base if there is a (1) changed in underlying majority beneficial ownership of the membership interests or (2) the membership interest was acquired within the past 12 months.

Value-shifting between subsidiaries

There are integrity measures being proposed to counter cost base uplift when an encumbered asset whose market value has been reduced, due to the intra-group creation of rights over the encumbered asset, are sold by a consolidated group.

Where a consolidated group sells an encumbered asset that is subject to rights belonging to another member of the group, the group would make a reduced taxable gain on sale of the encumbered asset. At the same time it is possible, under the current legislation, that the right retained could receive a market value cost base notwithstanding that no economic consideration is required to be provided.

This measure has been adopted to prevent this mischief from occurring – the mischief being a reduced taxable gain and recognition of a market value cost base for the right retained.

Ensuring certain deductible liabilities are not taken into account twice

There are currently integrity issues where certain liabilities, such as provisions for annual leave, are taken into account twice in the tax cost setting process when a subsidiary member joins a tax consolidated group. The Board of Taxation paper identified the following method for dealing with this issue:

1. Where an entity that has deductible liabilities is acquired by a consolidated group, the head company includes the amount at step 2 of the entry tax cost setting rules for those deductible liabilities in assessable income at the following times:
   - Where the deductible liability is a current liability for accounting purposes, the assessable income is brought to account over the 12 month period following the joining time; and
   - Where the deductible liability is a non-current liability for accounting purposes, the assessable income is brought to account over the 48 month period following the joining time;
2. Integrity rules will be considered where a subsidiary exits with group with a non-current liability, or a group is liquidated, within the 48 month period; and
3. In the case of an entity that is acquired progressively, the assessable amount reflects the acquired component of the deductible liabilities included at step 2 of the entry tax cost setting rules using a shortcut method to work out the acquired component.

BDO COMMENT

These are highly targeted technical amendments that appear to reflect specific intelligence gleaned by the ATO and which, in their view, is not in accordance with the intention of the legislation. The amendments are predominantly relating to issues considered by the Board of Taxation and which are currently in the consultation process.

INTERNATIONAL

International tax measures

The Government announced a significant tightening of Australia's thin capitalisation provisions as a measure of 'protecting the corporate tax base from erosion and loopholes'.

The Government strongly believes that the current thin capitalisation provisions, introduced in 2001, have been overly generous and have eroded the Australian corporate tax base through artificial loading of debt in Australia.

In addition, the Government also:

- Re-announced its intention to reform the non-portfolio dividend exemption
- Announced the abolition of the provision, which allows deductions for interest when deriving exempt foreign income
- Deferred the proposed reform of the controlled foreign company provisions.

Changes to the thin capitalisation provisions

The thin capitalisation provisions impose limits on 'debt deductions' (mostly interest expenses) incurred by Australian entities that are controlled by non-residents, as well as Australian entities that have foreign subsidiaries and/or branches. The provisions impose a cap on the amount of debt that these Australian entities can carry.

In most cases, the cap is calculated on a debt to equity ratio of 3:1, namely, for every $1 of equity, an entity can have up to $3 of deductible debt. If the relevant cap is exceeded, interest on the excess debt is not deductible.

The Government announced that from 1 July 2014, the following changes will apply:

- The debt to equity ratio of 3:1 applicable to general entities will be reduced to 1.5:1 (effectively 60 per cent gearing rather than 75 per cent gearing)
- The debt to equity ratios in respect of non-bank financial entities and banks will also be reduced significantly
- The alternative method for calculating the cap, the worldwide gearing ratio, will be reduced from 120 per cent to 100 per cent
- The other alternative method for calculating the cap, the arm's length test, will be referred to the Board of Taxation to make it easier to comply with and clarify in what circumstances the test should apply.

On the positive side, the Government also announced that:

- The 'debt deductions' threshold, below which the thin capitalisation provisions do not apply, will increase eight-fold from $250,000 to $2 million thereby exempting many Small & Medium Enterprises (SMEs) from the provisions all together
- The alternative method for calculating the cap, the worldwide gearing ratio, will also be available to inbound entities (not just outbound entities).

Non-portfolio dividend exemption

Currently Australian companies that own a non-portfolio shareholding (i.e. at least 10 per cent) in a foreign company are exempt from Australian income tax on dividends paid by the foreign company.

The Government re-announced its intention to reform the exemption so that:

- It is only available to returns on equity holdings (rather than debt holdings) and only those that are non-portfolio in nature (e.g. a substance over form test)
- It will allow the exemption to flow through trusts and partnerships (which is currently not available).

Interest deductions in respect of foreign exempt income

Under the current provisions, Australian entities are allowed a deduction for interest expenses (subject to thin capitalisation) even to the extent they derive exempt foreign income (eg non-portfolio dividends).

The Government is proposing to remove this concession. This will require Australian entities to apportion their interest expenses, and to the extent these expenses relate to the derivation of exempt foreign income, they will not be deductible.

Controlled foreign company provisions

The long-awaited reforms to the Australian controlled foreign company provisions and other foreign source attribution provisions have been further deferred, to be reconsidered after an Organisation for Economic Co-operation and Development analysis on these provisions is completed.

BDO COMMENT

While the changes to the thin capitalisation provisions have been expected for quite some time, they are still likely to trigger a major re-thinking of how foreign-owned Australian entities are funded. The tax savings of $1.5 billion that the Government is expecting from this measure are significant. However, the significant increase of the threshold under which the thin capitalisation provisions will not apply is a welcome announcement in respect of SMEs who incur significant costs in complying with these provisions.

Amendments to the Capital Gains Tax regime for foreign residents

The Government has announced two broad changes to the taxation of Capital Gains Tax (CGT) assets for foreign residents being:

- A tightening of the principal asset test in Subdivision 855-A of the Income Tax Assessment Act 1997 to prevent what would otherwise be taxable Australian real property from escaping CGT
- A 10 per cent non-final withholding tax on the disposal of certain taxable Australian property by a foreign resident.

The principal asset test

The changes to the principal asset test comprise of two components. The first is to ignore intercompany dealings between entities within the same tax consolidated group for the purposes of determining whether the entity being disposed of passes the principal asset test. The principal asset test only looks at the assets of the entity being disposed of. It is currently possible to artificially inflate the gross assets of the entity being disposed of in order to fail the principal asset test and, therefore, come under the CGT exemption available under Subdivision 855-A.

The second component is to take certain intangible assets, such as mining information and goodwill which are currently not considered taxable Australian real property, and treat them as taxable Australian real property provided they are attributable to taxable Australian real property such as the exploration and mining rights. According to the Government's press release, a number of foreign owned mining companies have been disposed of, and the foreign owner had not been taxed on the basis that the non-taxable Australian real property, including mining information, exceeded the value of the taxable Australian real property. In these cases the principle asset test would be failed and the foreign owner would be exempt under Subdivision 855-A. Under this example of the proposed amendments, the mining information will be included as 'taxable Australian property', which may result in the principle asset test being passed and, therefore, the Subdivision 855-A exemption would not be available.

These amendments will apply from Budget night.

Foreign Resident Withholding Tax

A 10 per cent non-final withholding tax will apply to the disposal of taxable Australian property by foreign residents. The purchaser will be obliged to withhold and remit 10 per cent of the proceeds of the sale of the property to the ATO. Similar regimes have been implemented in other major countries (i.e. USA and Canada) to overcome the difficulties of tax collection.

The withholding tax obligation will not apply to residential property transactions below $2.5 million.

The design and implementation of the regime will be developed through public consultation to minimise compliance cost.

BDO COMMENT

The change to the principal asset test, to treat mining information as a CGT asset for determining whether a sale of a CGT asset should be taxed, is perceived to be a specific measure against the mining industry. This measure has the capacity to significantly affect the flow of foreign capital investment into the mining industry.

Another withholding tax regime will impose a greater compliance burden to Australian resident purchasers who will be required to explain their withholding tax obligations to a foreign resident seller, and this may well be a contract negotiation point similar to gross-up clauses for interest withholding tax.

INDUSTRY

Natural resources

Petroleum Resource Rent Tax – legislative changes
The Government has confirmed that it will amend the Petroleum Resource Rent Tax (PRRT) rules to correct legislative deficiencies following the Full Federal Court decision in Esso Australia Resources Pty Ltd v Commissioner of Taxation (Esso).

The Esso case cast considerable doubt on the ability for taxpayers to claim deductible expenditure for the purposes of computing their PRRT taxable profit or loss.

These measures were previously announced in a joint media release dated 14 December 2012.

Issues
Following the Esso case, the ATO issued a Decision Impact Statement (DIS) which broadly set out their views on the application of several key aspects of the PRRT provisions.

The DIS stated that a number of important propositions could be drawn from the ESSO case, a key one being that the provisions do not allow for apportionment of PRRT expenditure where the liability to make a payment is not confined to (ie incurred wholly in relation to) the petroleum project.

The Esso case also raised questions about the capacity for taxpayers to deduct expenditures in circumstances where services are provided under contract.

The Government subsequently stated that the DIS 'creates uncertainty about the ability of PRRT taxpayers to deduct legitimate expenditures'.

The amendments should:

- Enable taxpayers to apportion expenditure in a manner consistent with the intended operation and policy intent of the PRRT regime
- Allow taxpayers to claim deductions for services acquired under third party contractual arrangements
- Preserve the requirement to look through arrangements with related entities in order to determine the extent to which payments are deductible, if at all, for PRRT purposes.

BDO COMMENT
Following the Esso decision, the PRRT measures were generally considered to be unworkable and prohibitively unfavourable. We welcome these amendments.

Mining rights and information first used for exploration deductible over time rather than immediately
The immediate deduction for the cost of assets first used for exploration will be amended in relation to the cost of mining rights and information. Subject to the exceptions noted below, costs of mining rights and information first used for exploration will be depreciated over the lesser of:

- 15 years, or
- The effective life of the mine that they lead to.

If the exploration is unsuccessful, the undeducted costs will be deductible when this is established.

The exceptions to this measure, which will continue to be immediately deductible (i.e. the new measure will not apply) are:

- The costs of mining rights from a relevant governmental issuing authority
- The costs of mining information from a relevant government authority
- The costs incurred by a taxpayer itself in generating new information or improving existing information
- Mining rights acquired by a farmee under a recognised 'farm-in, farm-out' arrangement.

The proposal paper which was released in relation to the measure indicates that it is intended to address integrity concerns over immediate deductions having been claimed for the cost (in some cases worth hundreds of millions or billions of dollars) of mining rights and information where there is a high probability that resources exist and only minor or confirmatory further exploration activity is required.

The proposal paper also indicates that the tax outcomes currently delivered through the ATO's tax rulings MT 2012/1 and MT 2012/2 in relation to farm-in, farm-out arrangements will be codified as part of this measure.

Date of effect

The measure will apply to taxpayers who start to hold the mining right or information after 7.30pm (AEST) on 14 May 2013 unless:

- The taxpayer has committed to the acquisition of the right or information (either directly or through the acquisition of an entity holding the asset) before that time, or
- They are taken by tax law to already hold the right or information before that time.

It is noted that any commitment will need to be objectively verifiable.

Consultation

The Government has stated that it will consult closely with industry on the design and implementation of the measure. Submissions in relation to the following matters have been requested by 12 July 2013:

- The methodology used to determined the effective life of the mine
- How the codification of the farm-in, farm-out rules could make the application of tax law more straight forward and/or improve support for genuine exploration without introducing integrity concerns
- When an exchange of mining rights should receive concessional tax treatment because the transaction does not give rise to integrity concerns.

BDO COMMENT

These measures have the potential to cause cash-flow problems and raise the real cost of exploration for companies in the production phase.

Superannuation

Although there were no new measures announced in the 2013 Budget, with all of the key superannuation measures being previously announced or introduced in the budgets of prior years, constant changes are contributing to uncertainty.

Concessional contributions caps

Two new superannuation temporary concessional contribution caps have been introduced. From 1 July 2013 individuals aged 60 years and over can contribute a maximum of $35,000 in concessional contributions per annum. From 1 July 2014 individuals aged 50 years and over can contribute up to the higher $35,000 cap.

This measure is somewhat diluted by the fact that, under the current rules, all superannuation members are expected to be able to contribute $35,000 in concessional contributions before the 2018 financial year.

High income earners – additional super tax

The Government included this new superannuation tax in the 2012 Budget announcement, but it has re-iterated again this year, and draft legislation has recently been released to allow the imposition of this new tax.

Where an individual's income for surcharge purposes (plus low rate contributions, which are essentially concessional contributions) exceeds $300,000, those contributions are to be subject to an additional tax of 15 per cent.

Retrospective application

The new contributions tax is applicable from 1 July 2012, and is expected to be assessed on income and contributions for the year ended 30 June 2013. While announced in the 2012 Budget, there has been no certainty regarding the application of the new tax until recently.

Excess concessional contributions

This new measure sees individuals being able to withdraw excess concessional contributions from superannuation and include them in personal income (paying tax at personal marginal tax rates plus an interest charge). For those individuals on less than the top marginal tax rate, this will provide a tax saving from the excess tax rate of 31.5 per cent (in addition to the 15 per cent already paid by the fund).

Taxing pension funds

Income from assets supporting pension accounts will be taxed at 15 per cent, where a member is receiving more than $100,000 of income each year (attributed to their pension account). The fund income limit is per member and, therefore, dependant upon the number of members in the fund.

The limit of $100,000 per member is to be indexed in accordance with the Consumer Price Index, but only increased in $10,000 increments.

Transition rules for CGT

To allow for individuals to appropriately manage their superannuation affairs, there are transitional rules regarding the inclusion of CGT in the $100,000 threshold:

- For assets held before 5 April 2013, the reform will only apply to capital gains realised after 1 July 2024
- For assets purchased from 5 April 2013 to 30 June 2014, individuals will have the choice of applying the reform to the entire capital gain, or only that part that accrues after 1 July 2014
- For assets that are purchased from 1 July 2014, the reform will apply to the entire capital gain.

BDO COMMENT

The continuing volume of superannuation changes is considerable cause for concern. Superannuation rules underwent a major overhaul in the 2006 Federal Budget, creating 'Simpler Super'. However, the Government has continued to 'tinker' with contributions and superannuation rules, in general, each six months for the past seven years.

The taxing of pension funds appears to have been proposed with very little industry consultation or consideration. The measure is complex and the transitional rules around capital gains adds another layer of difficulty.

The increasing complexity of superannuation, because of constant 'tinkering' and changes, erodes any confidence the public may have in the superannuation system.

Environmental sustainability

Reduction in projected carbon price yet no major cuts
The Budget has finally revealed the Government's predictions for the carbon price when the floating carbon price period commences on 1 July 2015. It has been revised down from $29 per tonne to $12.10 per tonne.

The Budget has also retained some key measures around funding for emissions reductions and energy efficiency, which provides welcome certainty for industry, at least until the election in September 2013.

There has also been a re-statement of our involvement in the second commitment period of the Kyoto Protocol as well as a greater linkage between land-based emission reductions and our national emission reductions target.

Industry assistance is largely linked to carbon price, but other assistance is not
Because a large part of the Government's assistance to industry is in the form of free carbon permits, the fact the projected carbon price has now been substantially lowered will not actually cost the Government any additional expenditure.

However, in the area where these revenue reductions do have an impact – cash payments to specific industries and tax cuts to families – the Government has been forced to make some changes to future measures in order to minimise the impact on the Budget and forward estimates, including:

- Tax cuts due to commence 1 July 2015 will be deferred until the carbon price recovers above $25.40 per tonne
- Coal industry assistance will be reduced in line with revised carbon price
- Uncommitted funds in the clean coal and carbon capture and storage projects will be returned to the Budget.

Clean Technology Investment Program remains
The Government has not reduced funding to this program and has taken steps to align grant funding expenditure with expected demand.

Carbon unit auction details announced
The Government has announced the details of forthcoming carbon unit auctions, following industry consultation. Three-eighths of each vintage will be auctioned in advance, with the first auction commencing in the first half of the 2014 calendar year in relation to carbon units for the 2015-16 year; this being the first year of a floating carbon price.

Greater linkage between Kyoto Obligations and land management abatement
In recognising abatement from cropland management, grazing land management, and revegetation towards our Kyoto obligations, the Government has been able to remove the need for the Non-Kyoto Carbon Fund, which was to have commenced on 1 July 2013. This measure will result in savings of $389.4 million.

BDO COMMENT
The carbon pricing mechanism and all of its related programs are proceeding with no major changes. However, many of the Budget announcements in this area may be academic given the Opposition's commitment to repealing this legislation, should they take power after the election.

There is a clear window of opportunity for industries to access some of the available assistance while these programs are still in place, particularly around the Clean Technology Investment Program.

It is also interesting to note the additional developments around land management, given that the Opposition's 'Direct Action Plan' largely centres on land use carbon offsets. This may be an area where there is more certainty for investment. Not-For-Profit sector reforms

Not-For-Profit sector reforms

Introducing a statutory definition of charity

The Government had previously announced in the 2011-12 Budget that it would introduce a statutory definition of charity for all Commonwealth legislation. Last month, draft legislation was released by the Government to give effect to the statutory definition of the term 'charity' and 'charitable purpose'. This is part of the Government's Not-For-Profit (NFP) reform agenda to strengthen and sustain the NFP sector.

The Government has introduced the proposed statutory definition to provide greater clarity and reduce uncertainty about the meaning of charity and charitable purpose, which were not previously defined for the purposes of the Commonwealth law. This will also assist the regulators in determining whether an entity is charitable, and consequently reduce the need for costly litigation.

The Government announced that the proposed definition will take effect from 1 January 2014, rather than 1 July 2013, as previously announced. The extended start date will provide time for the Australian Charities and Not-For-Profits Commission (ACNC) to develop guidance for charities in relation to the definition. The ACNC is the national regulator of charities.

Charities will not need to re-register when the proposed definition takes effect from 1 January 2014. The ACNC will assist charities if their registration requires adjustment to come under a purpose mentioned in the proposed legislation.

BDO COMMENT

The introduction of a statutory definition of the term charity is noteworthy and a welcome measure considering the current meaning is based on the principles of common law developed over 400 years, dating back to the Statute of Elizabeth of 1601.

However, there are concerns with the meaning of the term "disqualifying purposes" that could prevent an entity from qualifying as a charity, especially where the organisation operates commercial enterprises to support the charity. Also, the introduction of a statutory definition may result in transitional costs for some entities having to revisit their registration with the ACNC.

Later start date for Not-For-Profit tax concession reforms and conclusion of transitional arrangements

The Government has extended the start date to 1 July 2014 for the Not-For-Profit (NFP) tax concession reforms, previously announced in the 2011-12 Budget. The later start date will provide additional time for consultation and engagement with the NFP sector on this measure to ensure that there is opportunity for detailed stakeholder input. This will also provide additional time for those in the NFP sector who have commenced commercial activities since the announcement in the 2011-12 Budget.

The extended start date of 1 July 2014 will only apply to new unrelated commercial activities that commenced after the 2011-12 Budget. Existing unrelated commercial activities that commenced prior to 10 May 2011 will be governed by the transitional arrangements announced in the 2011-12 Budget. However, the transitional arrangements will cease from 1 July 2015.

The Government's forward estimates have included a small-scale threshold of $250,000, below which unrelated commercial activities will not be affected by the NFP reforms. These would typically include activities such as lamington fundraisers, school fetes and leasing of church halls. This threshold was the subject of public consultation in a discussion paper released in May 2011 and the Government has announced that this will be subject to further public consultation.

BDO COMMENT

While the extended start date of 1 July 2014 for the NFP reforms provides stakeholders with the opportunity to provide the necessary input, the delay in implementing these reforms, which were announced in the 2011-12 Budget, clearly adds to uncertainty.

ACROSS THE BOARD

Customs - Increase in import processing charge
The Government announced an increase of almost 50 per cent in the Import Processing Charge (IPC) for consignment values over $10,000. The new charge will come into effect on 1 July 2014.

BDO COMMENT
Given the quantum of the increase in the IPC charges, BDO questions whether the amount of the increase might be a precursor to an announcement to lower the current $1,000 low value import threshold which has been the subject of considerable debate in recent times, and would assist many in the retail sector who are struggling to compete against GST imports of under $1,000 value goods.

Australian Taxation Office compliance activity
The Government announced three specific Australian Taxation Office (ATO) compliance projects over the next four years, including:

- An increased focus on offshore marketing hubs and other business restructures aimed at profit shifting. At a cost of $109 million, the Government is expecting to raise additional revenue of $406 million
- A trusts taskforce targeting taxpayers involved in egregious tax avoidance and evasion using trust structures. At a cost of $68 million, the Government is expecting to raise additional revenue of $379 million
- A data-matching program, focusing on taxable government grants, sale of real property, shares and units in managed funds, sales through merchant debit and credit services, and trust and partnership distributions. At a cost of $78 million the Government is expecting to raise additional revenue of $610 million.

BDO COMMENT
The focus on offshore marketing hubs and other offshore restructuring, and the significant revenue expected from this focus, is in addition to the other international tax measures announced (which of themselves are expected to save the Government $1.5 billion). As this is a major focus area for the Government, foreign-owned Australian entities, and Australian entities with foreign operations, will need to review their international structures and operations carefully.

The focus on trust compliance is particularly interesting in light of the ongoing delays in the re-writing of the trust provisions and the great uncertainty that still exists in relation to many aspects of trust taxation in Australia. In fact, the Government appears to be putting the trust reform agenda back to the professional bodies' liaison groups, so we are no closer to advancing the cause of trust reform.

BDO questions whether the additional funding raised by a data-matching program will result in a continuation of the ATO's recent approach to clamping down on input tax credit claims and verification. The extra funding will ensure the ATO continues to closely examine a range of issues.

Monthly Pay-As-You-Go instalments — extension to other large entities

The Government will extend the requirement to make monthly Pay-As-You-Go (PAYG) income tax instalments to include all large entities in the PAYG instalment system, including trusts, superannuation funds, sole traders, and large investors. This is in addition to the already announced transition of monthly PAYG instalments for large corporate tax entities for which exposure draft legislation has been released for consideration, and ensures tax neutrality between different business structures.

Under the previously announced proposals corporate tax entities (companies and entities taxed as companies) will be required to comply with the new monthly regime which includes:

- From 1 January 2014, corporate tax entities with a Base Assessment Instalment Income (BAII) of $1 billion or more will be required to make PAYG instalments monthly
- From 1 January 2015, corporate tax entities with a BAII of $100 million or more will be required to make PAYG instalments monthly, and
- From 1 January 2016, corporate tax entities with a BAII of $20 million or more will be required to make PAYG instalments monthly.

Under the measures announced tonight, all other entities will come into the monthly regime as follows:

- From 1 January 2016, all other entities with a BAII of $1 billion or more will be required to make PAYG instalments monthly
- From 1 January 2017, all other entities with a BAII of $20 million or more will be required to make PAYG instalments monthly.

However, entities with a BAII of less than $100 million will not be required to make monthly PAYG instalments if they are (or their GST representative is) a quarterly or annual GST reporter, and if they are not a head company of a consolidated group, or a provisional head company of a Multiple Entry Consolidated (MEC) group.

The exposure draft legislation in relation to large corporate entities is contained in Tax Laws Amendment (2013 Measures No. 2) Bill 2013: Monthly PAYG instalments.

BDO COMMENT

This is clearly a pure revenue raising measure with nothing but administrative and cash-flow problems for the affected taxpayers.

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