PINNACLE GROUP
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TAX ALERT – AUSTRALIAN FEDERAL BUDGET 2013

OVERVIEW

Last week the Australia government handed down its budget.

This tax alert draws attention to many of the changes that affect foreign residents and high-net worth individuals.

THIN CAPITALISATION CHANGES

The thin capitalisation regime limits the capacity of multinational firms to move profit out of Australian by assigning excessive debt to their Australian operations. The regime limits the deductibility of interest for debt over a certain 'safe harbour limit'.

The government will change the safe harbour limit for general entities, reducing it from 3:1 to 1.5:1 on a debt to equity basis, or 75% to 60% on a debt to total asset basis. This change reduces the effectiveness of firms financing their Australian operations with tax-effective debt funding (instead of equity funding).

FOREIGN RESIDENT CGT WITHHOLDING TAX

The government will introduce a 10% non-final withholding tax on the disposal by foreign residents of certain taxable Australian property. The purchaser will be required to withhold and remit 10% of the proceeds from the sale.

The measure will not apply to residential property transactions under $2.5million or to disposals by Australian residents.

Further details relating to the regime will be realeased by the end of the 2013 calendar year.

The previously announced removal of the CGT discount for foreign and temporary tax residents will also apply in conjunction with the withholding tax regime.

INCREASE IN THE MEDICARE LEVY

The medicare levy rate will rise from 1.5% to 2% from 1 July 2014.

DEDUCTIONS RELATING TO FOREIGN EXEMPT INCOME

The concession that allows for a tax deduction to be claimed for interest relating to certain foreign exempt income will be removed.

REVISED TAX TREATY TO BE SIGNED WITH SWITZERLAND

It was recently announced that negotiations for the text of a revised Double Taxation Agreement treaty with Switzerland had concluded.

It is expected that the revised treaty will strengthen administrative assistance between Australian and Swiss revenue authorities, including overcoming long-standing bank secrecy provisions.

The revised treaty will mean greater cooperation and information sharing between the Australian government and the Swiss authorities.

The revision of this treaty (not updated since the 1980 treaty), is consistent with a strong international corporate tax avoidance push.

The treaty will be signed as soon as possible, subject to the respective domestic approval processes of each country.

We are seeing multi-government action on tax avoidance, led by countries like the US and other OECD countries.

Updated treaties and tax information exchange agreements are being signed by multiple jurisdictions as tax authorities investigate citizens who hide funds offshore in an effort to avoid tax.

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SUPERANNUATION REFORMS

As previously announced in the lead-up to the budget, the government will legislate several changes to the superannuation system. More details around these changes were released in the budget. A recap of the reforms is included below:

EXTRA 15% CONTRIBUTIONS TAX FOR HIGH INCOME EARNERS

As previously announced in last year's budget, the government will double the effective contributions tax from 15% to 30% for concessional contributions made on behalf of individuals with incomes greater than $300,000.

INCREASED CONCESSIONAL CONTRIBUTIONS CAP

The government will provide a $35,000 concessional cap to individuals who meet certain age requirements. From 1 July 2013, individuals aged 60 and over can access the new concessional cap. From 1 July 2014 individuals aged 50 and over can access the larger cap.

TAX-FREE PENSIONS EARNINGS CAPPED

The law will be amended to cap the tax exemption for earnings on superannuation assets that support income streams, to the first $100,000 for each individual from 1 July 2014.

Currently all earnings (such as dividend, interest and realised capital gains) on assets supporting income streams are tax-free.

After the changes, earnings on assets supporting income streams will only be tax-free for the first $100,000 for a financial year (per individual). Earnings above $100,000 will be taxed at the concessional rate of 15%. Capital gains that are subject to the tax will receive a 33% CGT discount, meaning they are effectively taxed at a rate of 10%.

SPECIAL CGT RULES FOR PENSION ASSETS

Special arrangements will apply for capital gains on assets supporting income streams:

- For assets purchased before 5 April 2013, the $100,000 earnings cap will only apply if the capital gain on the asset accrues after 1 July 2024. This allows some 11 years for decisions to be made regarding the disposal of assets (potentially with no capital gains tax consequences);
- For assets purchased between 5 April 2013 and 30 June 2014, the choice can be made whether to apply the $100,000 cap arrangement to the entire capital gain, or only that part of the capital gain that accrues after 1 July 2014;
- The entire capital gain on all assets purchased from 1 July 2014 will be affected by the $100,000 earnings cap.

Trustees of self-managed superannuation funds will need to plan carefully for the new rules, especially those with property assets, where the capital gain of a larger asset may lead to the new rules taking effect.

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