Pitcher Partners

Federal Budget 2018-19

Repurpose. Recycle. Re-elect?

Tuesday 8 May 2018

an independent member of BAKER TILLY INTERNATIONAL

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ATO SPOTLIGHT

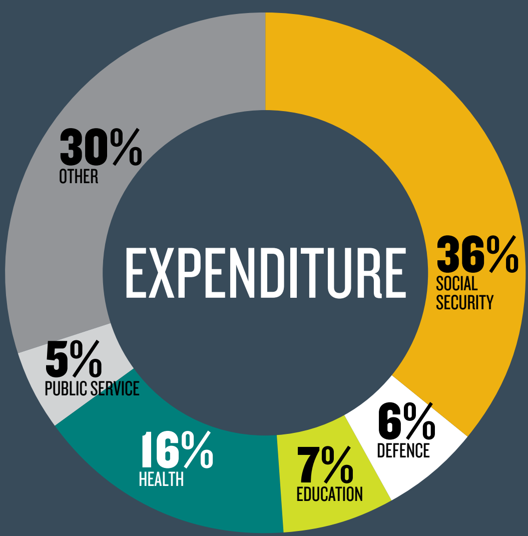
TRUSTS | INDIVIDUALS | R&D | VACANT LAND OWNERS | BLACK ECONOMY

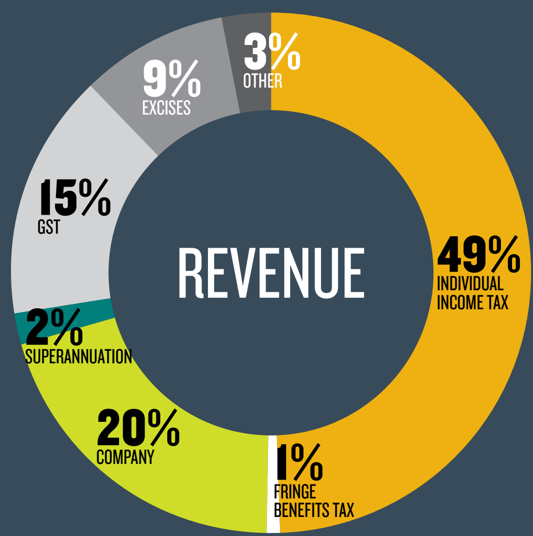
Federal Budget 2018-19 Highlights

TAXATION

TAX RELIEF TO INDIVIDUALS EARNING **<$90K**

BY 2024 TOP MARGINAL TAX RATE TO KICK IN AT **$200K**





$72B GROWTH OVER NEXT 5YRS

$32B ALLOCATED TO SOCIAL SECURITY

4.2% GOVERNMENT SPEND 2018-19

5.7% TAX TAKE IN 2018-19

$103B GROWTH OVER NEXT 5YRS

$57B FUNDED BY TAX ON INDIVIDUALS

ECONOMY

$14.5B DEFICIT (SURPLUS IN 2019-20)

2017-18 2.75% → 2018-19 3% REAL GDP

2.25% INFLATION (UP FROM 2%)

2017-18 5.5% → 2018-19 5.25% UNEMPLOYMENT

2018-19 2.75% | 2020-21 3.5% WAGE GROWTH

Budget overview

A safe political budget forecasts a continued recovery in the Economy, starting with a short term sugar hit.

Against a backdrop of reform in key economies, such as President Trump's recently announced major tax cuts in the US, Scott Morrison has passed up the opportunity for major economic reform. Faced with the political reality of recently not being able to pass its 10 year enterprise tax plan on corporate tax cuts, the Government has in this year's Budget instead focused on integrity measures and individual tax relief for most Australians.

With Australia projected to complete 31 years of uninterrupted growth, the Budget expects unemployment to fall slightly and wage growth to return to 'normal' levels. This contrasts with a total forecast net debt position of $349 billion. An innovative business in this position would critically assess its operations and make the tough strategic decision to improve its long term future prosperity.

In this Budget there is no longer term structural reform and very few new initiatives that will drive investment and lead to stronger economic growth. Consistent with last year's budget there is very little on Innovation, transitioning to new digital economies or support for internationalisation.

We are still much too reliant on income tax to sustain our position – there is no expansion of GST or other broader based taxes despite the retention of state-based taxes such as payroll, stamp duty and land tax that weigh on businesses.

A survey of Pitcher Partners' clients on the eve of the Budget found a simplified taxation system was their top priority – far exceeding the priority given to tax cuts.

This is an election focused budget structured to win the hearts and minds of middle Australia through tax cuts and differentiation from Labor on dividend franking tax refunds, while not impacting the current economic status quo.

While the personal tax cuts are welcome and appear generous, the reality of the forward revenue estimates is that the government remains heavily reliant on personal income tax collections to increase future revenue.

We are disappointed in the face of international business stimulation that the Government only extended the $20,000 instant asset write-off for businesses with turnover of less than $10 million for one more year. For most advanced economies, the tactic has not only been to increase government spending, but to stimulate private investment by providing significant incentives for business to invest in productive capacity. Middle-market businesses, which are the backbone of the economy and account for around one third of jobs and one third of economic activity, have yet again been largely ignored.

More than just being ignored, the Government has actively made running an SME more difficult. Undoubtedly, the focus on targeting the black economy will also increase the compliance burden on honest hard working business owners. Structurally proposed changes around trusts and the use of corporate beneficiaries as a means to finance working capital and growth is set to be removed, increasing funding difficulties for business.

Among the changes announced Tuesday night are:

- A new cap on the R&D offset of $4 million, and a sharp reduction in the amount that can be claimed by companies with turnovers above $20 million
- Integrity measures that deny tax deductibility of holding costs on vacant land for investors and potentially property developers

As with every Budget, there are winners and losers, but for business, increased complexity increases the cost of doing business. A range of confusing changes, from limits on R&D tax offsets to integrity measures targeted at property developers, could leave businesses wanting answers rather than tax cuts. Many sectors will be left trying to unpick complex changes at a time when SMEs have stressed the need for a simplified taxation system

RECYCLED

Changes to personal income tax rates

The Government has announced a number of measures that seek to reduce personal income tax in three stages over the next seven years.

Stage 1

During this period changes will apply from 1 July 2018 to 30 June 2022. The Government will introduce a new non-refundable Low and Middle Income Tax Offset (LMITO) designed to provide tax relief of up to $530 for taxpayers earning up to $90,000. The offset phases out from $90,001 to $125,333. This offset will be in addition to the existing Low Income Tax Offset (LITO).

The Government will also increase the upper threshold of the 32.5% tax bracket from $87,000 to $90,000.

Stage 2

Changes in this stage will take place from 1 July 2022, and involve increasing the LITO from $445 to $645, extending the upper threshold of the 19% tax bracket from $37,000 to $41,000, and further increasing the upper threshold of the 32.5% tax bracket from $90,000 to $120,000.

Stage 3

The final stage will involve a further increase in the upper threshold of the 32.5% tax bracket to $200,000 from 1 July 2024, removing the 37% tax bracket completely. For taxable incomes exceeding $200,000, taxpayers will pay the top marginal tax rate of 45% (excluding the 2% Medicare Levy).

Tax rates and thresholds for 2018-19 onwards

The table below summarises the announced personal tax rate and threshold changes (excluding the 2% Medicare Levy).

Tax rates and thresholds			
Rate	**2018-19 to 2021-22**	**2022-23 and 2023-24**	**2024-25 onwards**
0%	$0 - $18,200	$0 - $18,200	$0 - $18,200
19%	$18,201 - $37,000	$18,201 - $41,000	$18,201 - $41,000
32.5%	$37,001 - $90,000	$41,001 - $120,000	$41,001 - $200,000
37%	$90,001 - $180,000	$120,001 - $180,000	N/A
45%	$180,001+	$180,001+	$200,001+
LITO	Up to $445	Up to $645	Up to $645
LMITO	Up to $530		

Medicare Levy to remain at 2%

The Government had previously proposed to increase the Medicare Levy from 2% to 2.5% from 1 July 2019 to help finance the NDIS. However, citing an improving economy and fiscal position, the Government has decided not to proceed with this.

Medicare Levy low-income thresholds for 2017-18

For the 2017-18 income year, the Medicare Levy low-income threshold for singles will be increased to $21,980 (up from $21,655 in 2016-17). For couples with no children, the family income threshold will be increased to $37,089 (up from $36,541 in 2016-17). For each dependent child or student the family income threshold will increase by $3,406 (up from $3,356 in 2016-17).

For single seniors and pensioners eligible for the Seniors & Pensioners Tax Offset, the Medicare Levy low-income threshold will be increased to $34,758 (up from $34,244 in 2016-17). The family threshold for seniors and pensioners will be increased to $48,385 (up from $47,670), plus $3,406 for each dependent child or student.

Increased compliance activities

The Government will provide $130.8 million to the ATO from 1 July 2018 to increase compliance activities targeting individuals and their tax agents. This measure is a response to specific compliance issues for individual taxpayers previously identified by the ATO including incorrect reporting of foreign source income and over-claiming of deductions.

Business taxation

REPURPOSE

Extension of the accelerated depreciation concession

The Government has confirmed its intention to extend the accelerated depreciation concessions applicable to small business entities through to 30 June 2019.

Businesses with aggregated annual turnover of less than $10 million can obtain an immediate deduction for eligible assets purchased for less than $20,000. Prior to this measure's initial implementation, immediate deductions were only available for asset purchases costing less than $1,000.

While there are some exclusions to what assets are considered 'eligible assets' for the purposes of the concessions, these are minimal in nature and include assets such as capital works (for which deductions are available under different tax rules), horticultural plants, assets allocated to a low-value pool prior to applying the simplified depreciation rules, in-house software and certain lease assets.

A small business simplified depreciation pool remains available to assets costing greater than $20,000, whereby assets placed in the pool may be initially depreciated at 15% and 30% for each income year thereafter. Where the pool's written down value falls below the $20,000 threshold, it may also be eligible for an immediate deduction.

In addition to the above, the 'lock out' laws – which restrict access for five years to the simplified depreciation rules where a small business has previously opted out of them – will remain suspended until 30 June 2019.

This is a welcomed proposal, which can provide additional cash flow incentives to small business investing in capital assets.

REPURPOSE

Measures to discourage land banking

The Government has announced integrity measures to discourage land owners from holding vacant land, a process more commonly known as 'land banking'. From 1 July 2019, income tax deductions will be denied for expenses associated with holding vacant land, such as interest expenses and council rates.

This measure has been introduced amid concerns income tax deductions are being improperly claimed for expenses relating to the holding of vacant land, where that land is not being genuinely held for the purpose of earning assessable income.

Two exclusions will be available: (1) where a property has been constructed on the land, it has received approval to be occupied and it is available for rent; and (2) in respect of land being used by the owner to carry on a business, including a business of primary production.

The second exclusion is important for development groups that hold land over a long period of time (e.g. where a PSP may take a number of years). In many cases, land can be held in separate SPV entities and therefore it will be critical for the Government to clarify that this exclusion can be available where a single entity is part of a group of entities carrying on business.

Where deductions are denied, the announcement states that expenditure may form part of the cost base of the asset for CGT purposes. However, as land can be held on revenue account e.g. as trading stock or as a revenue asset, it will also be important to ensure the measures allow denied deductions to be included in the revenue cost of land.

REPURPOSE

Deductions denied for non-compliant PAYG withholding

From 1 July 2019, taxpayers will be unable to claim tax deductions for wage and contractor payments they make where they have not withheld tax under the Pay-As-You-Go (PAYG) withholding regime when required to do so.

Under these proposed measures, the ability to claim a tax deduction for payments to employees or contractors will be denied if taxpayers fail to deduct tax and remit it to the ATO under the PAYG regime. This can occur where taxpayers make payments to employees (and thus fail to withhold PAYG), or make payments to contractors who do not quote an ABN (and thus fail to withhold PAYG).

Whilst the ATO currently has the power to impose penalties on offending taxpayers, the proposed measures will act as a further disincentive for failing to meet PAYG obligations.

To ensure taxpayers meet their obligations under PAYG, it is necessary to correctly identify all circumstances where an obligation to withhold tax arises. This includes correctly identifying all persons who should be treated as employees (notwithstanding their purported treatment as contractors). It also includes instances where tax must be withheld on foreign employees working in Australia or when Australians are working overseas on international assignments. In addition, it is also imperative taxpayers identify those contractors who have not quoted ABNs to ensure that tax is withheld as required.

The introduction of Single Touch Payroll will mean payments made through payroll will be more closely scrutinised by the ATO, including instances where tax should have been withheld (but may not have been).

These newly announced measures add further impetus for all taxpayers to ensure they are compliant with their PAYG obligations going forward.

WASTE

Thin capitalisation changes

The thin capitalisation rules will be amended by requiring entities to align the value of their assets for thin capitalisation purposes with the value included in their financial statements.

This change aims to ensure asset valuations used to justify debt deductions are ‘robust’ – insofar as accounting principles are concerned. However, the change removes the flexibility allowed under the current law to enable the valuation for thin capitalisation purposes to more accurately align with commercial and economic values of assets, which may not necessarily be reflected in the carrying values in financial statements.

The Government will also ensure foreign controlled Australian consolidated entities and multiple-entry consolidated groups that control a foreign entity are treated as both outward and inward investment vehicles for thin capitalisation purposes. This means inbound investors can no longer access tests that were only intended for outward investors. This is a targeted measure that closes an existing loophole in the legislation and simply aligns the thin capitalisation rules with those that apply to non-consolidated groups.

These measures will apply to income years commencing on or after 1 July 2019, and are estimated to add revenue of $240 million over the forward estimates period.

R&D Tax Incentive reform

FRESH THINKING

Changes to the R&D Tax Incentive are proposed to apply from 1 July 2018 and will impact most taxpayer's currently claiming the incentive.

The measures are consistent with the Government's stated intention of rewarding those companies whose R&D activities provide the greatest spillover benefits to the Australian economy. The changes are estimated to produce savings of approximately $300 million per year - approximately 10% of the R&D tax benefits currently claimed by taxpayers.

For companies with annual group turnover of less than $20 million, the incentive will remain a refundable offset but at a reduced rate of 41.0 percent (down from 43.5) of eligible expenditure for the 2018-19 and later years. The reduced rate still provides a net additional benefit of 13.5 percent of eligible expenditure. Further, cash refunds for small R&D companies will be capped at $4 million per annum. The excess above that cap can be carried forward but only to be used as a non-refundable offset. R&D expenditure on clinical trials will not count towards this cap.

For companies with group turnover of $20 million or more, the R&D tax benefit will be dictated by the claimant company's "R&D intensity" – that is, the percentage that annual R&D expenditure bears to total expenditure. The incentive for large R&D companies will continue to be a non-refundable offset calculated at the claimant company's tax rate (27.5 per cent where group turnover for 2018-19 is between $20 million and $50 million, and 30 per cent where it exceeds $50 million) plus:

- 4 percentage points where R&D intensity is between 0 to 2 per cent;
- 6.5 percentage points where R&D intensity is between 2 per cent to 5 per cent;
- 9 percentage points where R&D intensity is between 5 per cent to 10 per cent; and
- 12.5 percentage points where R&D intensity is above 10 per cent.

The R&D expenditure cap for large R&D companies will be increased from $100 million to $150 million.

The integrity of the R&D program will be strengthened with increased resourcing for both regulators (the Australian Taxation Office and AusIndustry) and the publication of further guidance material. Other changes include providing the ATO with the ability to release details of companies claiming the incentive.

Pitcher Partners does not expect the changes to severely impact the level of R&D spending by small R&D companies, particularly given the ability to carry forward any offsets in excess of the $4 million refundable cap. However, in line with recent compliance activity, the increased resourcing available to both regulators will mean that taxpayers will likely face increased scrutiny in respect of their R&D claims.

Private taxation

FRESH THINKING

Integrity rules dealing with assignments of partnership interest

With effect from 8 May 2018, the Government will prevent partners in a partnership from accessing the CGT small business concessions when disposing of their rights to partnership income to an associated entity.

Whilst the details are currently limited, the Government announced the CGT small business concessions may no longer be available to partners of partnerships to reduce or eliminate a capital gain as a result of the assignment of a right to the future income of a partnership. The Budget announcement stated there will be no changes to the CGT small business concessions themselves, indicating that a specific integrity provision is likely to be introduced to address the Government's concerns.

WASTE

UPEs to be treated as loans under Division 7A

Unpaid present entitlements (UPEs) will be treated as loans under Division 7A, with effect from 1 July 2019. Other previously announced measures regarding Division 7A have also been delayed, commencing from 1 July 2019.

The announcement is silent regarding whether this measure will be limited to new UPEs created on or after 1 July 2019, or whether it will also capture pre-existing UPEs still on foot as at 1 July 2019. We note that existing UPEs may include both pre-16 December 2009 UPEs, as well as post-16 December 2009 UPEs placed on sub-trust arrangements.

Furthermore, the announcement is unclear about the date by which the UPE must be repaid or placed on complying loan terms. With regard to the current law and administrative practices, this date could be either the lodgement date for the tax return of the income year in which the present entitlement is first created, or possibly the lodgement date for the following year's return.

This measure will result in significant top up tax incurred by small businesses owners operating through trusts (utilising corporate beneficiaries). This will be the case even where 100% of the business profits are reinvested in the business. It is therefore disappointing this measure will not be introduced together with an exception for 'otherwise deductible' business loans.

International tax

FRESH THINKING

Tax measures affecting actors, sportspersons and the film industry

Australian tax residents and foreign individuals working in Australia should be mindful of announced changes to income attribution rules, which will seek to tax fame and image rights income to individuals personally from 1 July 2019. This tightening of the rules is accompanied by a small carrot in the form of additional funding for Australia's local film and related industries.

The Government has announced it will be providing $140 million over four years to attract foreign investment in film production and related industries, complementing the existing 'Location Offset' component of the Australian Screen Production Incentive tax rebate, and providing support for Australia's film industry.

In contrast, the budget targets high profile individuals (including actors and sportspersons) who licence their fame or image rights to related entities. The proposed measures seek to tax such individuals personally on income generated under these arrangements from 1 July 2019.

There is no detail at present regarding how the measures will be introduced. While we query the appropriateness of this proposal, it would seem sensible to incorporate them into Australia's existing Personal Services Income rules, which already capture certain acting income and appearance fees.

The use of image rights licensing companies is often a commercial necessity. Therefore, we note that such rules will need to allow those licensing their image rights (through companies) to claim foreign income tax offsets personally for any foreign tax paid on this income.

FRESH THINKING

Additional integrity measures for multinationals

The Budget demonstrated the Government's ongoing commitment to ensuring multinationals pay their fair share of tax, by expanding the definition of Significant Global Entities (SGE) and announcing the imminent release of a discussion paper on taxing digital business in Australia.

From income years commencing on or after 1 July 2018, the SGE definition will be expanded to include groups headed by private companies, trusts and partnerships. This closes a perceived loophole in the existing rules.

SGEs are exposed to a variety of enhanced compliance measures such as Country-by-Country reporting, the Multinational Anti Avoidance Law (MAAL), the diverted profits tax (DPT) and lodgement of general purpose financials, as well as enormous penalties.

In line with the OECD's first BEPS action item, identifying appropriate tax rules to deal with digital business is high on the Government's agenda. Over the past year the Government has been working with the G20 to bring the digital economy into the global tax net.

While no announcements were made in the Budget, the Treasurer announced a discussion paper will be released that explores options for taxing digital business in Australia. This consultation will be complex given the EU is struggling with reaching consensus in this area against the backdrop of tensions from the US.

Positive change for super

Small fund membership increased from four to six

The maximum number of fund members that can participate in a self-managed superannuation fund (SMSF) and a small APRA fund (SAF) will increase from four to six members effective 1 July 2019.

This increase should provide greater opportunities for families to pool wealth in a common superannuation fund structure for investment. Families participating jointly in this way may access investment opportunities that would not otherwise be available, such as the ability to acquire a significant commercial property. It may also make it easier for families to maintain specific assets/investments in a superannuation fund structure, and transition those assets/investments to the next generation.

However, we note a decision to include children in a family superannuation fund may not always be the best approach. It is important to remember all fund members have an equal say in investment and other fund management decisions, irrespective of the size of their superannuation balance. We have also seen examples where members may want to pursue different investment strategies as they are at different stages of life, which is often better pursued in separate superannuation funds.

The measure may also provide a mechanism to reduce the tax impact of the proposed Labor policy of denying a refund of franking credits in SMSFs (i.e. by introducing further assessable superannuation contributions to the SMSF).

Three yearly audit requirement

The requirement for annual audits will be changed to a three-yearly requirement for SMSFs with a good compliance record. To be eligible, SMSFs will need to have three consecutive years of clear audit reports and must have lodged all returns over that period within time.

The measure is stated to commence from 1 July 2019, however, it is not clear if the 2020 financial year will be the first year an audit exemption will be available. We welcome this measure, which will reduce the regulatory burden for SMSFs and associated compliance costs.

Super Guarantee opt-out

Individuals who have multiple employment arrangements, and where those arrangements result in employer superannuation contributions exceeding the $25,000 concessional contribution cap, will be able to nominate to exclude earnings from the superannuation guarantee regime from 1 July 2018. If the opt-out option is used, then generally such superannuation contributions would (instead) be paid to the employee directly as ordinary income/earnings.

The measure should limit the excess contribution situations that can inadvertently arise today and which generally result in additional compliance costs and penalties outside of the taxpayer's direct control.

Superannuation work test exemption for contributions by recent retirees

From 1 July 2019, the Government will introduce an exemption from the work test for voluntary superannuation contributions made by individuals aged between 65 to 74 in the first year the individual does not meet the work test requirement. The individual must also have a superannuation balance below $300,000 to qualify.

Currently, the work test restricts voluntary superannuation contributions from age 65 unless a person is gainfully employed for at least 40 hours in a period not exceeding 30 consecutive days in a financial year.

Opening up voluntary contributions to people in the first year of retirement is a welcome initiative, but we expect this measure to have limited application given how strict the eligibility requirements have been drafted.

Notice of intention to claim deductions

The Government announced measures aimed at improving the integrity of the personal contribution deduction process.

The deduction notice process is the mechanism that enables a superannuation fund to withhold contributions tax. The Government has highlighted its concern that some taxpayers are receiving the personal deduction but not paying contributions tax due to a failure to inform their superannuation fund of their intention to claim a tax deduction.

An additional $3.1 million of funding will be provided to the ATO to develop a new compliance model and for additional compliance resulting in an estimated $430 million in additional revenue over four years.

Additional superannuation measures designed to limit erosion of member balances

A number of measures have been announced to limit the unnecessary inadvertent erosion of member superannuation balances from 1 July 2019. These measures include a 3% annual cap on passive fees on low balance accounts (less than $6,000); a ban on exit fees; changes to insurance arrangements for low balance accounts, members under 25 or accounts that have been inactive for 13 months; and requiring the transfer of all low balance inactive superannuation accounts to the ATO.

The measures appear to be well-intentioned, however, we highlight that there may be inadvertent consequences. For example, the insurance changes are likely to see fund members under age 25 not opting into insurance.

The lack of insurance cover at a younger age may then have implications later in life. For example, it may be more difficult to obtain similar cover later in life or that cover would come at a higher cost. Therefore, it will be important for members to properly consider what these changes may mean, both now and in the future.

RECYCLED

Tax integrity measures for Trust distribution arrangements

Testamentary trusts

From 1 July 2019, concessionally taxed income distributed from testamentary trusts to minors will be restricted to income derived from assets owned by the deceased at the time they died, or investment of the proceeds from the sale of such assets. While minors are ordinarily taxed at the highest marginal tax rate on distributions from trusts, distributions to minors from testamentary trusts may be 'concessionally' taxed at normal adult rates.

There are existing anti-avoidance rules that apply to non-arm's length income and agreements entered into for the purpose of gaining the benefit of the concessional tax rules – such as transactions to inject additional assets or income into a testamentary trust for the benefit of providing a distribution to minors at the lower tax rate. The introduction of this integrity measure appears to broaden the scope of those integrity measures.

Round robin distributions

This measure applies to closely held trusts that undertake circular trust distributions in a "round robin" manner that arguably does not give rise to a tax liability. From 1 July 2019, these types of arrangements will give rise to tax on such distributions at the top marginal tax rate plus Medicare Levy.

Our main concern with this announcement is that it could introduce a significant level of compliance for trusts to trace and report ultimate trust distributions where there are no round-robin distributions.

RECYCLED

Denial of CGT discount for MITs and AMITs

The capital gains tax discount will be removed at the trust level for Managed Investment Trusts (MITs) and Attribution Managed Investment Trusts (AMITs).

Proposed to apply to payments made from 1 July 2019, beneficiaries who are not entitled to the CGT discount in their own right (for example, investors on revenue account, companies, and foreign investors) will be prevented from getting a benefit from the CGT discount being applied at the trust level.

These changes seek to ensure that MITs and AMITs operate as genuine flow-through tax vehicles and that investors are taxed on any income as if they had made a direct investment. Capital gains derived by MITs and AMITs will retain their character and be able to be distributed as capital gains, which can then be discounted in the hands of the beneficiary.

We have serious concerns with this announcement despite the Government indicating minimal tax revenue will be raised. In particular, there is a risk that expenses incurred by MITs and AMITs will be offset against gross (not discounted) capital gains derived by the MIT or AMIT. This could result in an increased amount of taxable capital gains being distributed to beneficiaries eligible for the CGT discount (like individuals) compared to an investor holding assets directly on CGT account.

We will closely monitor how the Government proposes to implement this measure to ensure appropriate outcomes.

Update to list of Information Exchange Countries

The Government will update the list of Information Exchange Countries to reflect the 56 new exchange-of-information agreements Australia has entered into since 2012. The update will be effective from 1 January 2019.

The jurisdictions that will be added are: Albania, Andorra, Austria, Azerbaijan, Bahrain, Barbados, Brazil, Bulgaria, Brunei, Cameroon, Chile, Colombia, Costa Rica, Croatia, Cyprus, Dominica, El Salvador, Estonia, Faroe Islands, Gabon, Georgia, Ghana, Greece, Greenland, Grenada, Guatemala, Iceland, Israel, Kazakhstan, Kenya, Latvia, Liberia, Liechtenstein, Lithuania, Luxembourg, Marshall Islands, Moldova, Montserrat, Nigeria, Niue, Philippines, Portugal, Samoa, Saudi Arabia, Senegal, Seychelles, Sint Maarten, Slovenia, St Lucia, Switzerland, Tunisia, Turkey, Uganda, Ukraine, Uruguay and Vanuatu.

From 1 January 2019, fund payments made by MITs to investors in these jurisdictions should be eligible to access the reduced 15% MIT withholding tax rate, instead of the default 30%.

Clarification of prior announcement for agricultural REITs

The Budget restates the Government's integrity package regarding stapled security structures that was announced on 27 March 2018. That announcement caused initial confusion, implying Real Estate Investment Trusts (REITs) holding agricultural land, and that are not within stapled security structures, might potentially be taxed as companies rather than retain their flow-through tax treatment.

Whilst not specifically announced as a change in the Budget Papers, they seem to have clarified that this change will only impact on foreign investors looking to access the concessional MIT withholding tax rate of 15% in agricultural REITs (i.e. there is no apparent intention to tax such agricultural REITs as companies).

Indirect taxes

Directors to become personally liable for GST and other indirect tax debts

Currently, the Director Penalty Regime is limited to a company's unpaid Pay As You Go (PAYG) withholding and Superannuation Guarantee Charge (SGC) obligations. Subject to certain requirements, the ATO can act to recover these amounts personally from directors.

The Government has announced it intends to extend the Director Penalty Regime to GST, luxury car tax and wine equalisation tax, making directors personally liable for the company's debts to the ATO in respect of those taxes. There is currently no date of effect contained in the Budget announcement.

We expect this measure to have broad ranging implications for all company directors, particularly in the GST space. To deal with this new level of personal risk, we recommend directors take steps now to understand their potential exposure, and put in place internal controls and measures to give them some level of comfort regarding their company's GST compliance.

Increasing the alcohol excise refund scheme for domestic brewers and distillers

The Government will increase the alcohol excise refund scheme cap from $30,000 to $100,000 per financial year, providing additional support to domestic brewers, distillers and producers of other fermented beverages such as non-traditional cider.

An additional measure will extend the concessional draught beer excise rates to eight-litre or bigger kegs (current concessional rate applies to containers exceeding 48 litres) from 1 July 2019. Whilst large breweries typically use 50-litre kegs, craft brewers often use smaller kegs, therefore this new measure will remove disadvantages and create a level playing field for smaller to medium sized craft breweries.

Online hotel bookings and GST

The Government is targeting the GST that is not currently paid on the difference between the price overseas tourism operators pay for hotel stays in Australia and the price they charge their customers.

In 2005, the Government introduced measures designed to exclude overseas tourism operators from Australia's GST net. The 2005 measures enabled overseas entities to remain outside the Australian GST net, thereby simplifying compliance for both the overseas entities and the Tax Office in the process. It was recognised at the time that GST would not be collected on the overseas operator's mark-up.

What has changed, some 13 years later, is the significant increase in online hotel booking sites, including sites run by overseas operators that can be accessed by Australian residents to book accommodation in Australia. Through the advent of technology, those measures are now disadvantaging Australian tourism operators and causing GST leakage.

From 1 July 2019, offshore suppliers will be required to include supplies of Australian hotel accommodation in their GST turnover for the purpose of determining whether they exceed the $75,000 GST registration threshold. Australian-based tourism operators are likely to welcome the change, as it places them on a level playing field with their overseas counterparts.

REPURPOSE

Significant number of integrity measures to be introduced

In keeping with its lower, simpler and fairer objective, the Government is determined to introduce a number of integrity measures to deal with the black economy. The package includes a range of recommendations of the Black Economy Taskforce. As part of its Budget, the Government released its response to the Black Economy Taskforce Final Report 'Tackling the black economy', providing the first whole-of-government blueprint for tackling the issue.

Limiting cash payments to $10,000

From 1 July 2019 there will be a limit of $10,000 for cash payments made to businesses for goods and services. Currently, large undocumented cash payments can be used to avoid tax or to launder money from criminal activity. Transactions over the threshold will have to be made through an electronic payment system or cheque.

There is no quantifiable estimated impact from this measure but it will support the black economy and associated revenue measures. Notably, transactions with financial institutions or consumer-to-consumer non-business transactions will not be affected.

New and enhanced ATO enforcement

The ATO will receive $318.5 million over four years to implement new strategies to combat the black economy. The Black Economy Taskforce found low-level enforcement and visibility made existing laws ineffective, hence there is to be a focus on visibility and targeted ATO activity.

The enforcement strategy includes new mobile strike teams and an increased audit presence, a Black Economy Hotline to report black economy and illegal phoenix activities, improved government data analytics and educational activities. This will support the new multi-agency Black Economy Standing Taskforce and ensure a more coordinated approach to combatting black economy behaviours.

This measure is estimated to improve revenue by $3 billion over the forward estimates period.

Improved business identification

Following the recommendation of the Black Economy Taskforce to create a single business register, the 2018-19 Budget provides $19.3 million to develop a detailed business case to improve the way the existing Companies Register, Australian Business Register and the Business Names Register interact. While a single business register will be aimed at reducing regulatory burden for businesses and will help to provide real-time robust identification and verification of businesses, we are concerned the transition to the new register may involve significant red tape and compliance costs for entities in the middle market.

Reforms to combat illegal phoenixing

Amendments will be made to both the corporations and tax laws to give regulators further tools to help deter and disrupt illegal phoenix activity.

The proposed measures include targeting those who conduct or facilitate illegal phoenixing; measures to prevent directors improperly backdating resignations to avoid liability or prosecution; limits on the ability of directors to resign when this would leave the company with no directors; restrictions on the ability of related creditors to vote on the appointment, removal or replacement of an external administrator; extending the director penalty regime to cover GST, luxury car tax and wine equalisation payments; and an expansion to the ATO's power to retain refunds where there are outstanding tax lodgements.

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ATO SPOTLIGHT

TRUSTS | INDIVIDUALS | R&D | VACANT LAND OWNERS | BLACK ECONOMY

Federal Budget 2018-19 Highlights

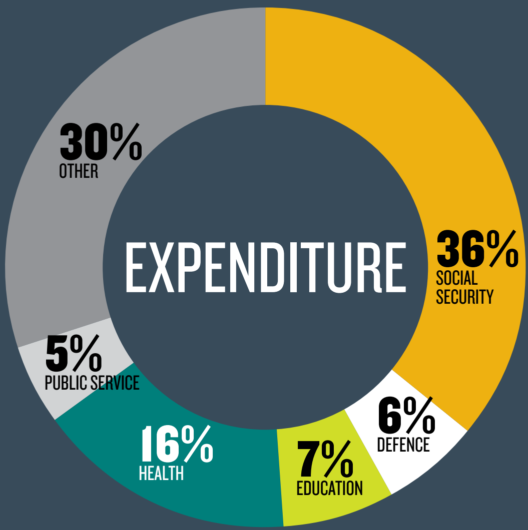
TAXATION

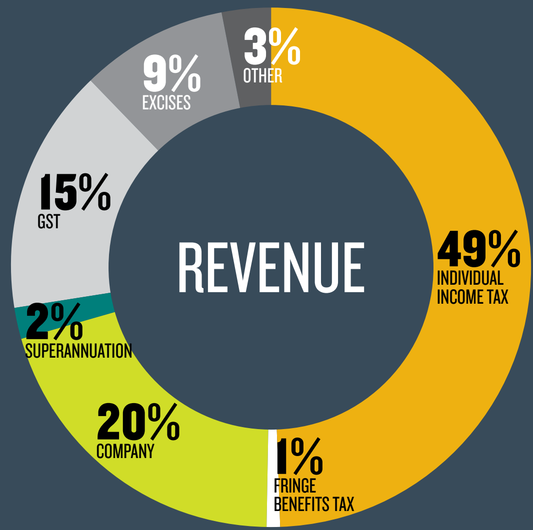
TAX RELIEF TO INDIVIDUALS EARNING

<$90K

BY 2024 TOP MARGINAL TAX RATE TO KICK IN AT

$200K





$72B GROWTH OVER NEXT 5YRS

$32B ALLOCATED TO SOCIAL SECURITY

4.2% GOVERNMENT SPEND 2018-19

5.7% TAX TAKE IN 2018-19

$103B GROWTH OVER NEXT 5YRS

$57B FUNDED BY TAX ON INDIVIDUALS

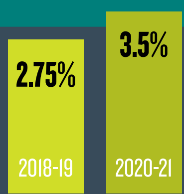
ECONOMY

$14.5B DEFICIT (SURPLUS IN 2019-20)

2017-18 2.75% → 2018-19 3% REAL GDP

2.25% INFLATION (UP FROM 2%)

2017-18 5.5% → 2018-19 5.25% UNEMPLOYMENT



WAGE GROWTH