Federal Budget 2016-17 Tax Changes (AKA Tax White Paper)

Dr Justin Dabner CTA

Associate Professor, Law School at James Cook University in Cairns, Adjunct research fellow with the Faculty of Business and Economics, Monash University, Director, LKM & JHD Products and Services Pty Ltd, Registered Tax Agent.

Justin.Dabner@jcu.edu.au

Mob 0412 283 702

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Introduction

Tax revenues are forecast to increase from 23.5% of GDP in 2015-16 to 25.1% of GDP by 2019-20.

Expenditures are expected to fall from 25.8% to 25.2% of GDP over the same period.

Over the four year period the government's nominal tax receipts are forecast to increase by 30%. Tax receipts will amount to $500 billion by 2019-20. Whilst much of the increase is predicated on growth new tax measures will also need to contribute, and in a big way. The government plans to collect an additional $28 billion each year!

1 Small business

Overview

• The SBE turnover threshold will be increased from $2m to $10m from 1 July 2016 for the purposes of various tax concessions other than the small business CGT concessions.

• The unincorporated small business tax discount will be increased in phases over 10 years from the current 5% to 16%. The cap of $1,000 per individual per year is retained.

• GST reporting requirements for small businesses will be simplified from 1 July 2017.

Details of main changes

Increased turnover threshold for small business income tax concessions

The increased threshold means businesses with an annual turnover of less than $10m (a further 90,000 companies) will be able to access existing SBE income tax concessions including the:

- lower small business corporate tax rate,
- simplified depreciation rules including the instant asset write off threshold of $20,000 available until 30 June 2017,
- simplified trading stock rules,
- option to account for GST on a cash basis and pay GST instalments as calculated by the ATO,
- simplified method of paying PAYG instalments calculated by the ATO, and
- other tax concessions such as the extension of the FBT exemption for work-related portable electronic devices available from 1 April 2016 and the immediate deduction of professional expenses under s 40-880 of ITAA 1997.

The SBE rules and their threshold date from 2007 (although based on the STS rules introduced in 2001). Upon the name change in 2007 the annual turnover threshold in the eligibility test increased from $1 million to $2 million. Had the threshold been indexed it would be almost $2.5 million in today's terms.

Where entities are to benefit from this greater coverage from 1 July 2016 they should consider deferring the acquisition of capital assets below $20,000 until after that date to ensure immediate deductibility. Such businesses, with a high debtor, small creditor profile (eg services industries) might have a one off benefit in the form of brought forward input credits by moving to a cash basis of reporting for GST.

Query whether the new SBE small business genuine restructure roll over will also extend to this greater category of entities. In fact, a legitimate question is whether the definition of SBE will continue to expand with the greater access to the lower company tax rate that is proposed through to 2023/24 – see below.

Unincorporated small business tax discount increased

First increasing to 8% on 1 July 2016, the discount will be available to individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than $5m up, from the $2m threshold. The gradual increase is intended to coincide with the staggered cuts in the corporate tax rate to 25% (although really there is no assimilation between the respective benefits from these tax measures). The tax discount will be increased as follows:

Income year	*Discount rate*
2016/17 to 2023/24	8%
2024/25	10%
2025/26	13%
2026/27 and later	16%

Although the existing $1,000 cap is to remain this is a permanent benefit in contrast to the reduction in the SBE company tax rate which can be “washed out” upon distribution of the profits in the form of dividends to shareholders facing a marginal tax rate greater than the company tax rate. Importantly, the discount measures apply to recipients of SBE income through a trust.

The effect of the increased discount rate will be that to access the full amount of the offset SBE unincorporated income tax could be as low as $6,250 (2026/27) down from $20,000 this year. Or, in other words, assuming no other income and rates remain the same SBE unincorporated income of around $42,000 down from around $87,000 will be needed to access the full $1,000 discount.

One result of these changes is that we now face three different small business thresholds depending on the concession at issue.

GST reporting requirements simplified for SBEs

SBEs are to more easily be able to classify transactions, and prepare and lodge their business activity statements. A trial of the new simpler reporting arrangements will commence on 1 July 2016.

2 Companies

Overview

• The company tax rate will be reduced to 25% over 10 years.

• Amendments will be made to Division 7A from 1 July 2018.

Details of main changes

Staggered cuts to the company tax rate

The company tax rate will be progressively reduced to 25% over 10 years. From the 2016/17 income year, the company tax rate for SBEs will be reduced to 27.5%. This threshold to access the 27.5% tax rate will be progressively increased to ultimately have all companies at that rate in the 2023/24 income year as follows:

Income year	Annual aggregated turnover threshold
2017/18	$25m
2018/19	$50m
2019/20	$100m
2020/21	$250m
2021/22	$500m
2022/23	$1b
2023/24	None

The company tax rate will be further reduced progressively from the 2024/25 income year as follows:

Income year	Company tax rate
2024/25	27%
2025/26	26%
2026/27	25%

In contrast to the 2015 measure reducing the SBE company tax rate, franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

The increasing gap between the highest marginal rate of tax and the company tax rate will place a greater emphasis on tax planning and attention to Div 7A in particular. The benefit for many resident taxpayers is illusory as they will pay more personal tax on dividends in the absence of franking credits. Foreign shareholders though are big winners given that withholding tax is not payable on fully franked dividends. Even then this may mean that they have less foreign tax credits in their home country so the ultimate winners may be foreign governments.

The government (eventually) revealed that the cost to the budget over 10 years of this measure is $48 billion.

Division 7A

The amendments will include:

- a self-correction mechanism for inadvertent breaches of Div 7A to allow a voluntary correction without penalty,
- safe-harbour rules, such as for the use of assets,
- simplified Div 7A loan arrangements, including having a single compliant loan duration of 10 years and better aligning of the minimum interest rate with commercial transactions, and
- technical adjustments to improve the operation of Div 7A and provide greater certainty.

The amendments draw on a number of recommendations from the Board of Taxation's post-implementation review of Division 7A. The Board has developed a reform model called the 'Amortisation Model'. Under this model, loans would be repayable over a 10-year period, have reduced documentation requirements, and have greater flexibility in repaying interest and the principal. More particularly:

- There should be no requirement for a formal written agreement between the parties. However, written or electronic evidence showing that a loan was entered into must exist by lodgement day for the income year in which the loan was made.

- The statutory interest rate would be set at the start of the loan and fixed over the term of the loan.

- The statutory interest rate would be the RBA's indicator lending rate for a small business; variable; other; overdraft for the month of May immediately before the start of that income year.

- The maximum loan term would be 10 years.

- The prescribed maximum loan balances during the term of the loan (including any accumulated interest) would be as follows:

  - 75 per cent of the original loan by the end of year three;
  - 55 per cent of the original loan by the end of year five;
  - 25 per cent of the original loan by the end of year eight; and
  - 0 per cent of the original loan (that is, fully repaid) by the end of year 10.

- Subject to meeting the maximum loan balances, there would be no specified annual principal repayments.
- Interest would be able to be accrued annually but would have to be paid by the end of years three, five, eight and 10.
- Interest deductibility would be governed by existing income tax rules.

Failure to make the repayments by the end of the milestone period would result in the private company being taken to have paid a dividend to the entity with the amount of the deemed dividend based on the amount of the shortfall in the payment required.

Complying 25-year loans would be grandfathered whilst all other pre-existing Division 7A loans would be transitioned to the new 10-year loans. In accordance with this all existing complying seven-year loans would have their terms extended to the new maximum of 10 years.

The Amortisation Model has an additional feature that will assist trading trusts wishing to reinvest profits as working capital. This is a 'business income election' exemption, under which unpaid present entitlements (UPEs) owed to corporate beneficiaries will not be subject to Division 7A if the trustee makes a once-and-for-all election to forgo the CGT discount concession on assets other than goodwill. The logic here is that had the funds been actually distributed to the company then any capital assets acquired with the funds would not have benefited from a CGT discount.

The Board also proposed:

- simpler safe harbour rules for regulating the use of company assets by shareholders;
- a 'self-correction mechanism' that would help ensure compliance by taxpayers who inadvertently breach the provisions, coupled with proportionate penalties to promote voluntary compliance; and
- a new approach to imposing and remitting administrative penalties on deemed dividends, to reduce the implicit additional penalty that can arise as a result of deemed dividends being unfranked.

Safe harbour rules

The Board's recommendations as to the safe harbour rules distinguish between those that would apply to depreciating assets and those that would apply to appreciating assets, such as land and buildings:

- for depreciating assets, a rental charge could apply, similar to that of an operating lease, comprising a finance amount (or interest amount), a depreciation component (being the cost of the asset to the lessor) and an amount for the relevant asset's other operating costs.

- for appreciating assets, a usage charge could apply, calculated by multiplying the statutory interest rate by the asset's indexed value, which could be updated with an arm's length valuation every five years, thus reducing the need for yearly valuations.

Self-correction mechanism

The self-correction mechanism would have following features:

- Qualifying taxpayers could self-assess their eligibility for an exception to Division 7A that will operate to reverse the effect of a prior deemed dividend.

- Eligibility for the exception will be based on the conduct that caused the deemed dividend being unintentional and that appropriate steps are taken to ensure that affected parties are placed in the position they would have been in had the dividend not arisen.

- A taxpayer who validly exercises self-correction may be liable for a penalty reflecting the degree of culpability (the self-correction penalty).

3 Individuals and families

Overview

• The 37% marginal tax rate threshold will increase from $80,000 to $87,000 from 1 July 2016.

• The low-income thresholds for the Medicare levy and surcharge will increase from the 2015/16 income year.

• The pause in the indexation of the income thresholds for the Medicare levy surcharge and the private health insurance rebate will continue for a further 3 years from 1 July 2018.

• Income tax exemptions will be provided for ADF personnel deployed in Afghanistan, the Middle East and in international waters with effect from 1 January until 31 December 2016.

• Six organisations have been added to the list of specifically-listed deductible gift recipients.

Details of main changes

Personal income tax relief

This measure reduces the marginal income tax rate on taxable incomes between $80,000 and $87,000 from 37% to 32.5% from the 2016/17 income year. For those earning $87,000 a year, the tax saving from increasing the tax threshold results in a tax saving of $321 a year. This tinkering does not address bracket creep which affects taxpayers at all income levels.

The temporary budget repair levy of 2% on those earning $180,000 or more remains temporary and ends 30 June 2017.

Medicare levy and surcharge

The increases take into account movements in the CPI. The threshold for singles will increase to $21,335 (up from $20,896 for the 2014/15 year). For couples with no children, the threshold will increase to $36,001 (up from $35,261 for the 2014/15 year).

For single seniors and pensioners, the threshold will be increased to $33,738 (up from $33,044 for the 2014/15 year). For senior and pensioner couples with no children, the threshold will be increased to $46,966 (up from $46,000 for the 2014/15 year).

The child-student component of the income threshold for all families increases to $3,306 (up from $3,238 for the 2014/15 year).

As for the surcharge the low-income threshold increases as follows:

- the surcharge payable on taxable income for a person who is married (or both married and a beneficiary of a trust) to $21,335 (up from $20,896 for the 2014/15 year), and
- the surcharge on reportable fringe benefits to $21,335 (up from $20,896 in the 2014/15 year).

Backpacker tax

The so-called "backpacker tax" is not addressed. Thus from 1 July 2016 working holiday visa holders will lose access to the tax free threshold and be taxed at 32.5% from their first dollar earned. Currently those in Australia for more than 6 months are taxed at the resident rates of tax. The proposed change will see these "backpackers" pay around $6,500 tax on previously exempt earnings of around $20,000.

4 Superannuation - Contributions

Overview

• The threshold at which high income earners pay additional contributions tax will be lowered to $250,000 from 1 July 2017. The annual cap on concessional superannuation contributions will also be reduced to $25,000.

• Individuals with a superannuation balance less than $500,000 will be allowed to make additional concessional contributions where they have not reached their concessional contributions cap in previous years, with effect from 1 July 2017.

• A lifetime non-concessional contributions cap of $500,000 will be introduced.

• The current restrictions on people aged 65 to 74 from making superannuation contributions for their retirement will be removed from 1 July 2017.

• From 1 July 2017 all individuals up to age 75 will be allowed to claim an income tax deduction for personal superannuation contributions.

• A low income superannuation tax offset (LISTO) will be introduced to reduce tax on superannuation contributions for low income earners from 1 July 2017.

• The income threshold for the receiving spouse (whether married or de facto) of the low income spouse tax offset will be increased to $37,000 from 1 July 2017.

Details of main changes

Additional tax on concessional contributions threshold and concessional contributions cap reduced

The Division 293 threshold will be lowered from $300,000 to $250,000.

The annual cap on concessional superannuation contributions will also be reduced to $25,000 (currently $30,000 under age 50; $35,000 for ages 50 and over). The start date of 1 July 2017 provides an opportunity for taxpayers to maximize concessional contributions for the next two years whilst they can.

From 1 July 2017, the government will include notional (estimated) and actual employer contributions in the concessional contributions cap for members of unfunded defined benefits schemes and constitutionally protected funds. Members of these funds will have opportunities to salary sacrifice commensurate with members of accumulation funds. For individuals who were members of a funded defined benefits scheme as at 12 May 2009, the existing grandfathering arrangements will continue.

Catch-up concessional superannuation contributions

From 1 July 2017 amounts below the contribution caps are to be carried forward on a rolling basis for a period of 5 consecutive years. The measure will allow people with lower contributions, interrupted work patterns or irregular capacity to make contributions, to make "catch-up" payments from the 2018/19 year.

Lifetime cap for non-concessional superannuation contributions

The lifetime cap will take into account all non-concessional contributions made on or after 1 July 2007, from which time the ATO has reliable contributions records, and commenced from 7.30 pm (AEST) on 3 May 2016.

The lifetime non-concessional cap replaces the existing annual caps which allow annual non-concessional contributions of up to $180,000 per year (or $540,000 every three years for individuals aged under 65).

Contributions made before commencement cannot result in an excess: ie excess can stay in fund. However, excess contributions made after commencement will need to be removed or be subject to 47% tax. This limits the ability to top up a fund that has not performed or made losses. The counting of non-concessional amounts to date might also be regarded as retrospective.

After-tax contributions made into defined benefits accounts and constitutionally protected funds will be included in an individual's lifetime non-concessional cap. If a member of a defined benefits fund exceeds their lifetime cap, ongoing non-concessional contributions to the defined benefits account can continue but the member will be required to remove, on an annual basis, an equivalent amount (including proxy earnings) from any accumulation account they hold. The amount that could be removed from any accumulation accounts will be limited to the amount of non-concessional contributions made into those accounts since 1 July 2007. Contributions made to a defined benefits account will not be required to be removed. The government will consult to ensure commensurate treatment of individuals for whom no amount of post 1 July 2007 non-concessional contributions are available to be removed.

The CGT cap (currently $1.415 million) will be retained. Thus, SBE taxpayers eligible for CGT concessions remain able to transfer proceeds from realising their business into a superannuation fund.

Harmonising contribution rules for people aged 65 to 74

People under the age of 75 wishing to make voluntary contributions will no longer have to satisfy a work test and will be able to receive contributions from their spouse (currently not permissible if over 70) – deduction availability subject to the new $500,000 cap.

Currently, the work test requires individuals aged 65 or over to be in gainful employment for at least 40 hours within 30 consecutive days in a financial year before their superannuation fund can accept any contributions for them.

Restrictions on personal superannuation contribution deductions eased

The ability for all individuals up to age 75 to claim an income tax deduction for personal superannuation contributions removes a bias in the system against self-employed persons. Currently, there is 'a maximum earnings as an employee' condition which needs to be satisfied in order to claim a deduction for personal superannuation contributions. Broadly, less than 10% of the total of taxpayer's assessable income, reportable fringe benefits and reportable superannuation contributions may be in relation to activities as an employee or no deductions for contributions are available. This has the effect that many self-employed professionals who work independently but are deemed employees under the superannuation guarantee law cannot make further voluntary deductible contributions.

Individuals who are partially self-employed and partially wage and salary earners, and individuals whose employers do not offer salary sacrifice arrangements will benefit from these changed arrangements (query whether the measure applies to those who are not employed, such as retirees). One effect will be that salary sacrifice arrangements for superannuation may no longer be necessary as an employee will be able to make deductible contributions to their superannuation fund (subject to the cap) at any time during the year.

To access the tax deduction, individuals will lodge a notice of their intention to claim the deduction with their superannuation provider before they lodge their income tax return. Individuals can choose how much of their personal superannuation contribution to claim a deduction for.

However, individuals that are members of certain prescribed funds will not be entitled to deduct contributions to those schemes. Prescribed funds will include all untaxed funds, all commonwealth defined benefits schemes, and any state, territory or corporate defined benefits schemes that choose to be prescribed. If a member of a prescribed fund wishes to claim a deduction, they may choose to make a personal contribution to another superannuation fund.

Low income superannuation tax offset introduced

The LISTO will provide a non-refundable tax offset to superannuation funds of 15%, based on the tax paid on concessional contributions made on behalf of low income earners, up to a cap of $500. The LISTO will apply to members with adjusted taxable income up to $37,000 that have had a concessional contribution made on their behalf.

The measure avoids the situation in which low income earners would pay more tax on savings placed into superannuation than on income earned outside of superannuation. It replaces the current low income superannuation contribution.

Low income spouse tax offset threshold increased

The low income threshold for the receiving spouse of the 18% low income spouse tax offset will be increased from $10,800 to $37,000 but remains capped at $540 (for $3,000 contribution). The current upper threshold is $13,800 which will be lifted to $40,000 (contribution amount is reduced dollar for dollar that the receiving spouse's income exceeds $37,000).

5 Superannuation – Benefits and Earnings

Overview

• The tax exemption on earnings of assets supporting Transition to Retirement Income Streams will be removed from 1 July 2017.

• A balance cap of $1.6m on the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase will be introduced from 1 July 2017.

• The anti-detriment provision in respect of death benefits from superannuation will be removed from 1 July 2017.

Details of main changes

Transition to retirement income streams (TRISs)

Earnings from assets supporting TRISs will no longer be eligible for tax exemption but rather will be taxed at the accumulation phase rate of 15%. Gains from these assets will also cease to be exempt although the one third discount will mean that the gains remain only taxed at 10%. Furthermore, the capacity to take a TRIS as a tax free lump sum will be curtailed. These measures will apply to all TRISs from 1 July 2017.

Together with the addition restrictions on non-concessional contributions and the impact this will have on re-contributions strategies the attractiveness of TRISs will be significantly curtailed.

$1.6m superannuation transfer balance cap introduced

The cap applies to the total amount of accumulated superannuation an individual can transfer into the tax-free retirement phase.

Where an individual accumulates amounts in excess of $1.6m, they will be able to maintain this excess amount in an accumulation phase account (where earnings will be taxed at the concessional rate of 15%). Members already in the retirement phase with balances above $1.6m will be required to reduce their retirement balance to $1.6m by 1 July 2017. Excess balances for these members may be converted to superannuation accumulation phase accounts and taxed at the 15% rate.

A tax on amounts that are transferred in excess of the $1.6m cap (including earnings on these excess transferred amounts) will be applied, similar to the tax treatment that applies to excess non-concessional contributions. Presumably, a tax rate of 15% would apply to these earnings but the announcement suggests that the excess is also taxed. In the alternative, the excess can be removed from the superannuation fund, presumably to be included in taxable income along with any associated earnings (plus a charge for the delay in the ATO recouping income tax on that income for that financial year?).

The amount of cap space remaining for a member seeking to make more than one transfer into a retirement phase account will be determined by apportionment. That is, as the threshold is indexed the percentage available will be maintained.

Commensurate treatment for members of defined benefits schemes will be achieved through changes to the tax arrangements for pension amounts over $100,000 from 1 July 2017. Pension payments over $100,000 per annum paid to members of unfunded defined benefit schemes and constitutionally protected funds providing defined pensions, will continue to be taxed at full marginal rates, however the 10% tax offset will be capped at $10,000. Furthermore, for members of funded defined benefit schemes, 50% of pension amounts over $100,000 per annum will now be taxed at the individual's marginal tax rate.

Many issues need to be resolved in relation to this measure. In particular, the treatment of assets that exceed the value of the threshold will need to be determined – can only a notional amount be allocated for example. The details released to date would seem to encourage the allocation of high growth assets towards the pension account as the relevant valuation is as at the date of transfer.

This cap may also see added imperative where one spouse is likely to breach their cap to both make contributions on behalf of a spouse (with or without the potential 18% tax offset) or engage in contributions splitting, again whether or not concessional or non-concessional. This restriction may also see a greater imperative to maximize the other two great tax effective investment strategies: the family home and negative gearing!

This is viewed as a retrospective change to the superannuation laws.

Anti-detriment death benefit provision removed

An anti-detriment payment is an additional lump sum amount that may be paid to an eligible dependant when a lump sum death benefit is paid. The payment represents a refund of the 15% contributions tax that has been paid by the deceased member over their lifetime.

Whether a fund provides an anti-detriment payment to its members depends on the governing rules of the fund. There is no legal requirement to make the payment. If the fund does pay an anti-detriment payment, the trustee can claim an income tax deduction in the financial year in which the lump sum is paid.

Where the death benefit is paid to a spouse, former spouse or a dependent child, the whole amount including the anti-detriment payment is tax-free. In this way the anti-detriment provision can effectively result in a refund of a member's lifetime superannuation contributions tax payments into an estate, where the beneficiary is the dependant of the member (spouse, former spouse or child).

Removing the anti-detriment provision is intended to better align the treatment of lump sum death benefits across all superannuation funds and the treatment of bequests outside of superannuation. Considered to be inconsistently applied and difficult to administer, this will potentially diminish the amount of a death benefit payment to dependants.

Lump sum death benefits to dependants will remain tax free.

6 The Big End of Town

Overview

• The proposed measure addressing the double counting of deductible liabilities under the tax consolidation regime announced in the 2013/14 Budget will be modified.

• The treatment of deferred tax liabilities under the tax consolidation regime will be amended.

• A consolidations integrity measure concerning liabilities arising from securitisation arrangements announced in the 2014/15 Budget will be extended to apply to non-AFIs.

• Simplified TOFA rules to apply from 1 January 2018.

• The tax treatment of asset backed financing arrangements such as deferred payment arrangements and hire purchase arrangements will be amended.

Details of main changes

Modified deductible liabilities measure for consolidated groups

The measure to address the tax benefit arising from the double counting of deductible liabilities under the tax consolidation regime will be modified such that a consolidated group that acquires a subsidiary with deductible liabilities will no longer include those liabilities in the consolidation entry tax cost setting process, thus removing a double tax benefit.

The original measure required a consolidated group to recognise an additional income amount over the first 4 years after acquiring an entity with deductible liabilities. The change to the measure is intended to remove inequitable consequences to taxpayers identified in the consultation on the 2013/14 budget measure, namely that it could apply even in the absence of double taxation, and extend the time over which the amounts are to be accounted for.

The amendment will mean that head companies of consolidated groups will no longer be required to bring to account assessable income amounts corresponding to the deductible liabilities of a joining entity. Instead, when calculating the allocable cost amount (ACA) of the joining entity, deductible liabilities will be excluded. As a result, the assets of the acquired entity will have a lower tax cost base which may reduce future tax depreciation deductions.

The start date for this measure will be deferred from 14 May 2013 to 1 July 2016.

Treatment of deferred tax liabilities in consolidation regime

The treatment of deferred tax liabilities under the tax consolidation regime will be amended by removing adjustments relating to deferred tax liabilities from the consolidation entry and exit tax cost-setting rules.

The measure is intended to address a commercial/tax mismatch, more closely align the commercial and tax outcomes and improve the integrity of the tax consolidation regime by ensuring that any benefit arising from a change in the value of a liability is accounted for. This change will also reduce the complexity involved in the joining and leaving process.

The measure will apply to joining and leaving events under transactions that commence after the date the amending legislation is introduced into parliament.

Broader integrity measure for liabilities from securitised assets

An integrity measure concerning accounting liabilities arising from securitisation arrangements announced in the 2014/15 Budget will be extended to also apply to non-financial institutions with securitisation arrangements. The amendments were necessary because as the liability exists for accounting purposes, but the asset is not recognised for tax purposes, an unintended result could arise when an entity joins or leaves a consolidated or MEC group. The original proposal only applies where a member of the group is an authorised deposit taking institution (ADI) or a financial entity.

Thus these liabilities will be disregarded for all entities if the relevant securitised asset is not recognised for tax purposes. The broadened measure will apply to transactions that commence on or after 7:30pm AEST on 3 May 2016. Transitional rules will apply to arrangements that commence before this time.

TOFA rules to be simplified

Proposed measures include:

- strengthening and simplifying the existing link between tax and accounting in the TOFA rules,
- simplified accruals and realisation rules (which will reduce the number of taxpayers that come within the TOFA rules), to reduce the arrangements where spreading of gains and losses is required under TOFA and simplify the required calculations,
- a new tax hedging regime which is easier to access, encompasses more types of risk management arrangements (including risk management of a portfolio of assets), and removes the direct link to financial accounting, and
- simplified rules for the taxation of gains and losses on foreign currency to preserve the current tax outcomes but streamline the legislation.

The reform of the TOFA rules is intended to remove the majority of taxpayers from the TOFA regime, resulting in lower compliance costs, provide simpler rules and more certainty. It will also incorporate government policy that was reflected in the following measures previously announced but not enacted:

- *amendments to tax hedging rules* to ensure they operate as intended and to provide further certainty — announced in the 2011/12 Budget,
- *functional currency rules* — extending the range of entities that can use a functional currency to allow certain trusts and partnerships keeping accounts in a foreign currency to calculate net income using that foreign currency — announced in the 2011/12 Budget, and
- *foreign currency regulations — technical and compliance cost savings amendments* — first announced in the Mid-Year Economic and Fiscal Outlook 2004/05.

The new simplified TOFA rules will apply to income years on or after 1 January 2018.

Of course the TOFA rules broadly only apply to entities that either elect to embrace the rules or have a turnover of $100 million or more, assets of $300 million or more or financial assets of $100 million or more.

Changes to tax treatment for asset backed financing

The tax treatment of asset backed financing arrangements, such as deferred payment arrangements and hire purchase arrangements, will be clarified to ensure they are treated in the same way as financing arrangements based on interest bearing loans or investments. It is expected that this will particularly assist large infrastructure funding.

Discussion paper on mandatory disclosure

A discussion paper has been issued seeking views on a mandatory disclosure rule for aggressive tax arrangements.

7 Investment Incentives

Overview

• Tax incentives for investing in early-stage innovative companies to be expanded.

• Funding arrangements to attract more venture capital investment to be expanded.

• A tax and regulatory framework will be introduced for two new types of CIVs.

Details of main changes

Expanding tax incentives for early-stage investors

In the Mid-Year Economic and Fiscal Outlook 2015/16 the government announced tax incentives applying from 2016/17 to promote investment in early stage innovative companies, including a:

- 20% non-refundable tax offset capped at $200,000 per investor per year, and
- CGT exemption, provided investments are held for at least 3 years and less than 10 years.

The concessions were announced to apply to investments in companies that were incorporated during the last 3 income years and that are undertaking an "eligible business", the scope of which was to be determined by the government in consultation with industry. In addition, the company could not be listed on any stock exchange and must have expenditure of less than $1m and income of less than $200,000 in the previous income year.

Following consultation the measures are to be amended to better target investment in innovative companies that face difficulty attracting capital and business expertise. The amendments include:

- reducing the holding period from 3 years to 12 months for investors to access the CGT exemption,
- a time limit on incorporation and criteria for determining if a company is an innovation company under the definition of "eligible business",
- requiring that the investor and innovation company are non-affiliates, and
- limiting the investment amount for non-sophisticated investors to qualify for the tax offset to $50,000 or less per income year.

Funding arrangements for venture capital investment expanded

The Mid-Year Economic and Fiscal Outlook 2015/16 measure "National Innovation and Science Agenda — new arrangement for venture capital investment" provided for tax concessions for Venture Capital Limited Partnerships (VCLPs), namely investment vehicles for those investing in innovative companies at the early and growth stages of a startup.

Under the arrangements:

- partners in a new Early Stage Venture Capital Limited Partnership (ESVCLP) will receive a 10% non-refundable tax offset on capital invested during the year,
- the maximum fund size for new ESVCLPs will be increased from $100 million to $200 million,
- ESVCLPs will no longer need to divest a company when its value exceeds $250 million.

These measures are further expanded to:

- add a transitional arrangement that allows conditionally registered funds that become unconditionally registered after 7 December 2015 to access the tax offset if the criteria are met,
- relax the requirement for very small entities to provide an auditors' statement of assets,
- extend the increase in fund size from $100m to $200m for new ESVCLPs to also apply to existing ESVCLPs, and
- ensure that the venture capital tax concessions are available for FinTech, banking and insurance related activities.

New collective investment vehicles

A corporate CIV will be introduced for income years starting on or after 1 July 2017 and a limited partnership CIV will be introduced for income years starting on or after 1 July 2018. The new CIVs will be required to meet similar eligibility criteria as managed investment trusts, such as being widely held and engaging in primarily passive investment. Investors in these new CIVs will generally be taxed as if they had invested directly.

This measure is intended to allow fund managers to offer investment products using vehicles that are commonly in use overseas. Apparently corporate vehicles are better suited for offering retail investment products (especially into Asia) whereas the partnership structure is more suited to wholesale investment, particularly by overseas pension funds. The measure is part of an Asian Nations initiative that Australia has signed up to.

8 International Tax

Overview

• A 40% tax on the profits of multinational corporations that are artificially diverted from Australia will be introduced from 1 July 2017.

• Transfer pricing rules will be amended to give effect to OECD recommendations, effective from 1 July 2016.

• Rules developed by the OECD to eliminate hybrid mismatch arrangements will be implemented from 1 January 2018.

• Administrative penalties imposed on significant global entities will be increased from 1 July 2017.

Details of main changes

Diverted profits tax (DPT)

A 40% diverted profits tax (DPT) on the profits of multinational corporations that are artificially diverted from Australia to apply where:

- diversion to a related party results in an amount of income tax being paid overseas that is less than 80% of the amount of income tax that would otherwise have been paid in Australia (‘effective tax mismatch’) – ie arrangement reduces the tax paid on the profits by more than 20% to under a 24% rate,
- reasonable to conclude that the arrangement is designed to secure a tax reduction, and
- insufficient economic substance (ie reasonable conclusion that transactions designed to achieve mismatch where tax reduction benefit exceeds non-tax benefits of arrangement).

Application to significant global entities (ie global annual revenue of $1b or more) that are Australian residents or that have a permanent establishment in Australia. Exemption where Australian annual turnover of less than $25m.

Not to be imposed on a self-assessment basis. Liability to the tax only where FCT issues a DPT assessment (within 7 years). Liability is imposed at a rate of 40% of the “diverted profits amount”, assessed by the Commissioner as follows:

- where the deduction claimed by the Australian taxpayer is considered to exceed an arm's length amount, the provisional diverted profits amount will be 30% of the transaction expense,
- otherwise the provisional diverted profits amount will be based on the best estimate of the diverted taxable profit that can reasonably be made by the Commissioner, and

- where the debt levels of a significant global entity fall within the thin capitalisation safe harbour, only the pricing of the debt and not the amount of the debt will be taken into account in determining any DPT liability.

An offset will be allowed for any Australian taxes paid on the diverted profits (eg withholding taxes) but will not be reduced by any amount of foreign tax paid on the diverted profits. A DPT assessment will also include an interest charge.

Following the issue of a DPT assessment, a 12-month review period applies during which the FCT may consider any further information. This reflects the fact that the rule is intended as a weapon against MNCs that may not be co-operating with the ATO during an audit, so placing an onus on them to justify their arrangements.

This proposal departs from the OECD's attempts to create a uniform international response to multinational avoidance. Furthermore, it can be expected that it will be difficult to reconcile this measure with Australia's tax treaty obligations given the proposal that the DPT will not be reduced by the amount of foreign tax paid. It will also be interesting to see how existing Advanced Pricing Agreements could be affected by the DPT.

Transfer pricing

The proposed amendments legislate actions 8 to 10 of the OECD's Action Plan on BEPS dealing with:

- intangibles (action 8),
- contractual allocations of risk (article 9), and
- profit allocations arising from uncommercial transactions (article 10).

In essence the changes are designed to ensure that transfer pricing analysis reflects the economic substance of a transaction.

OECD hybrid mismatch arrangement rules

Under action 2 the OECD recommended that governments implement domestic rules (eg double non-taxation, double deduction, long-term deferral) to neutralise the effect of hybrid instruments and entities. These may include provisions that:

- prevent exemption or non-recognition for payments that are deductible by the payer,
- deny a deduction for a payment that is not included in income by the recipient, and
- deny a deduction for a payment that is also deductible in another jurisdiction.

These rules are good in theory but raise many difficulties, not the least of which is the need for advisers (and the ATO) to now be across foreign tax rules (and any changes to them) so as to appreciate when a mismatch may arise. The plan is that all countries will move to similar mismatch rules but until that happens the first countries off the block (such as now Australia) will be imposing a significant compliance obligation on MNCs dealing with entities in the country. Even once other countries have moved to a similar regime it will be necessary to trace funds flows through chains of entities in a global group, and apportion deduction denials across the various jurisdictions that have implemented the regime. It is surprising, therefore, that the application of the measures are not restricted by the 'significant global entity' threshold as used in the MAAL.

Increased administrative penalties for significant global entities

Penalties relating to the lodgment of tax documents to the ATO (eg tax returns, BAS's, country by country reports) will be raised from a maximum penalty of $4,500 to $450,000 and penalties relating to making false and misleading statements to the ATO will be doubled.

9 GST and other indirect taxes

Overview

• GST will be extended to low value goods imported by consumers from 1 July 2017.

• A discussion paper has been released providing options to deal with the double taxation that arises when using digital currencies (such as Bitcoin) to buy goods and services already subject to GST.

• Tobacco excise and excise-equivalent customs duties will be subject to four annual increases of 12.5% from 1 September 2017.

• The WET rebate cap will be reduced to $350,000 on 1 July 2017 and to $290,000 on 1 July 2018.

• The excise refund scheme will be extended to domestic distilleries and producers of low strength fermented beverages such as non-traditional cider from 1 July 2017.

• Access to refunds under the Indirect Tax Concession Scheme has been granted or extended to diplomats and consuls from Cyprus, Estonia and Finland as well as the Organisation for the Prohibition of Chemical Weapons.

Details of main changes

GST extended to low value goods imported by consumers

The intent of this measure is that low value goods imported by consumers will face the same tax regime as goods that are sourced domestically. That is, the current $1,000 exemption threshold will be removed. Overseas suppliers that have an Australian turnover of $75,000 or more will be required to register for, collect and remit GST for low value goods supplied to consumers in Australia.

The Productivity Commission had estimated it would cost $2 billion to collect the additional $600 million of additional tax revenue from dropping the threshold. This estimate was based on the assumption that all parcels would be subject to the same GST collection method as currently applies to imports costing above $1,000. That is, each parcel would be individually processed by Customs and Border Protection, with the GST being collected from the Australian consumer before the parcel was released.

The proposed vendor registration system is meant to remove the additional cost burden from the need to stop goods at the border. It presumes that the overseas vendor has complied with the relevant GST requirements.

However, the information currently required to be provided on an international mail declaration would provide no indication as to whether GST had been collected and remitted to the ATO.

Even if the item did indicate whether GST had been collected there are difficulties with an overseas vendor registration system. Firstly, if the overseas supplier declares that it is not required to be registered and so the imported good(s) are not subject to GST (because its annual Australian turnover is less than $75,000) would an overseas supplier simply be able to note on the parcel that GST registration was not required? If so, how would customs determine the accuracy of that statement?

What if the overseas supplier is required to be registered based on turnover, but has not registered and has not collected GST? Again, it is unlikely Customs and Border Protection would know whether an overseas supplier was required to register for GST. And if an overseas supplier was unwilling to register for GST despite being over the turnover threshold, would they willingly acknowledge this? If it was acknowledged on the parcel that registration was required but had not occurred, would the ATO pursue the overseas company, or would Customs and Border Protection revert back to current collection procedures and require the Australian consumer to pay the outstanding GST? Essentially, any GST obligations imposed on international suppliers directly will be non-enforceable, and hence rely on voluntary cooperation by suppliers.

Finally, where the overseas supplier is registered, and has collected GST from the Australian consumer there is still no guarantee that the GST would be correctly remitted to the ATO. But the cost of auditing such an entity would likely be prohibitive.

On the other hand, there clearly is an equity issue here for domestic businesses and the government's move would be consistent with overseas developments and its recent so-called "Netflix tax" proposal from the 2015 budget.

This change will require the unanimous agreement of the states and territories (which seems to exist).

Tobacco excise to increase

The increases will take place from 1 September 2017 each year through to 1 September 2020. They will be in addition to existing indexation to average weekly ordinary time earnings. These four annual increases will take Australia's excise on a cigarette to almost 69% of the average price of a cigarette (assuming there are no other changes to cigarette prices over this period).

In addition, the duty-free tobacco allowance will be limited to 25 cigarettes (or equivalent) from 1 July 2017. This is down from the current allowance of 50 cigarettes.

Amendments will also be made to the *Customs Act 1901* and the *Excise Act 1901* to provide enforcement officers with access to tiered offences and appropriate penalties. This will increase the range of enforcement options available for illicit tobacco offences.

Wine equalisation tax rebate cap reduced

At the same time as GST was introduced, the government introduced WET. WET is a tax of 29% of the wholesale value of wine.

WET affects wine manufacturers, wholesalers and importers. As it is levied on the last wholesale transaction before the retailer. So the WET element becomes part of the retailer's cost base and is passed on to the end consumer.

A producer rebate scheme was introduced in 2004 to alleviate the impost of WET, and entitles wine producers to a rebate of 29% of the tax on domestic sales. Wine producers may be entitled to a credit (rebate) of the WET amount paid on a wine dealing up to a maximum of $500,000 each financial year.

The rebate has been particularly helpful for smaller producers, as while a couple of dozen very large wine companies account for well over 90% of Australia's wine production, there are many smaller ventures that make up the rest.

The government plans to address integrity concerns with the WET rebate by reducing the rebate cap from $500,000 to $350,000 on 1 July 2017 and to $290,000 on 1 July 2018 and tightening the eligibility criteria from 1 July 2019.

Under the tightened eligibility criteria for the rebate, a wine producer must own a winery or have a long-term lease over a winery and sell packaged, branded wine domestically. Thus anyone not making their own wine, but selling under their own label will not be eligible for the WET rebate from 1 July 2019. This will also impact on many genuine wine sellers who may be too small to be able to afford their own wineries but who are genuine winemakers.

Excise refund scheme extended to distillers

All alcoholic beverages over 1.15% alcohol by volume that will be consumed in Australia are subject to either excise duty or WET. Alcohol is subject to excise duty if it does not fall under the WET definition of ‘wine’

Excise rates are expressed per litre of alcohol for alcoholic beverages. Excise rates on alcohol are indexed twice a year in line with the consumer price index – generally on 1 February and 1 August.

Since 1 July 2012 breweries may be eligible for a brewery refund equal to 60% of the excise duty paid on beer up to a maximum of $30,000 per financial year.

From 1 July 2017 producers of whisky, vodka, gin, liqueur and producers of low strength fermented beverages, such as non-traditional cider, will be eligible for the excise refund scheme as well.

The scheme will not be extended to most alcopop producers (ie those that merely purchase the spirits and add the soda and other flavours), nor to wine producers who benefit from the WET rebate.

Sugar tax

No UK or French style sugar tax imposed (yet).

10 Tax administration

Overview

• A Tax Avoidance Taskforce will be established within the ATO to undertake enhanced compliance activities targeting multinationals, large public and private groups, and high-wealth individuals.

• Individuals who disclose information on tax avoidance to the ATO will receive improved protection from 1 July 2018.

• The government is encouraging all companies to adopt the Tax Transparency Code from 2016/17.

• The operation of the Australian Public Service including the ATO will be reviewed to achieve efficiencies and manage their transformation to a more modern public sector.

Details of main changes

Tax Avoidance Taskforce

The government will provide the ATO with $679m over four years to establish the Tax Avoidance Taskforce (first announced 3 Feb 2016) – expected to involve a team of 1,300 people including 390 new specialized officers headed by the FCT. The Taskforce is to work closely with partner agencies including the ACC, the AFP and AUSTRAC. New legislation will be introduced that will allow the ATO to improve information sharing with the ASIC. Part of the work of the Taskforce will be testing the law through litigation where there is deliberate tax avoidance and reporting to the government and the public.

External experts will be appointed to play a role in support of the Taskforce, including a panel of eminent former judges which will review proposed settlements with the ATO to ensure they are fair and appropriate.

The Taskforce is expected to recover $3.7b in tax liabilities over four years.

Protection for tax whistleblowers

Legislation exists at both State and Federal level in Australia protecting whistleblowers who inform on the public system. However, limited legislation exists in relation to those whistleblowing against private individuals or concerns other than informing in relation to breaches of the corporations law.

The ATO does maintain a tax evasion referral centre and provides various avenues to report tax evasion as well as misfeasance by tax officers. However, there is no protections for those whistleblowing on private individuals or entities.

The proposal is to introduce legislation that will protect the identity of whistleblowers and also protect them from victimisation, criminal prosecution and civil action for disclosing information to the ATO. The types of individuals that will be protected include employees, and former employees, and advisers to taxpayers.

Notably, it is not proposed to go as far as the US False Claims legislation, or even the IRS's whistleblowing program, under whistleblowers can share in recoveries or awards can be paid to them. It is Greens policy that Australia adopt such a scheme.

All companies encouraged to adopt Tax Transparency Code (TTC)

The Board of Taxation released a discussion paper on a TTC in December 2015, and recommended that businesses with Australian turnover of between $100m and $500m should adopt Part A of the TTC, which covers:

- a reconciliation of accounting profit to tax expense and to income tax paid or payable,
- identification of material temporary and non-temporary differences, and
- identification of effective company tax rates for Australian and global operations.

It was recommended that large businesses (ie businesses with Australian turnover of $500m or more) adopt Parts A and B of the TTC. Part B of the TTC covers:

- the business' approach to tax strategy and governance,
- a tax contribution summary for corporate taxes paid, and
- information about international related party dealings, financing and tax concessions.

Whilst the government encourages all companies to adopt the TTC, consideration of additional oversight or penalties for misleading disclosure of TTC information is not dealt with. Presumably, the sanctions for providing misleading disclosure in the Corporations Law would have an application. Possibly the AASB will develop guidance material to assist businesses in meeting the standard required by the TTC and to establish a common definition of the term 'effective tax rate' to ensure consistency.

The ATO has had a legislative duty to report information about certain corporate tax entities since 2013–14. This requirement primarily relates to corporate tax entities with total income of $100 million or more and Australian–owned resident private companies with total income of $200 million or more. The Report of Entity Tax Information includes total income, taxable income and income tax payable for these entities.

This reporting has proved controversial, not only due to the publication of sensitive information, but also due to the reception it has received, largely negative. The TTC provides an opportunity for corporates to go on the front foot to explain and clarify the amount of tax paid.

Public sector efficiency review

In relation to the ATO, the government plans to achieve efficiency savings of $21.8m over four years from 2016/17 by:

- reducing stand alone and co-located ATO shopfronts in favour of myGov shopfronts,
- actively promoting digital service delivery,
- expanding ATO external compliance assurance processes, and
- implementing more efficient processes for external scrutiny of the ATO.

The ATO is also to be encouraged to publish law companion guides, with a view to reducing lengthy tax law provisions. These guidelines are to be produced at the same time as new legislation, where possible.

11 Labor's Tax Proposals

- 27.5% (and ultimately 25%) company tax rate limited to companies with less than $2m turnover.
- tax free retirement accounts to be limited but no retrospective application of the $1.6m superannuation cap.
- retention of the 2% deficit repair levy on people earning more than $180,000.
- negative gearing on existing investment properties quarantined from 1 July 2017.
- the higher income superannuation charge threshold to be reduced to $250,000.
- additional international tax avoidance rules.
- "Australian angel investment scheme" to be introduced.
- increase the tobacco excise.

Details of main changes

Negative gearing

Negative gearing limited to new housing from 1 July 2017. All investments made before this date not be affected.

From 1 July 2017 losses from new investments in shares and existing properties can still be used to offset investment income tax liabilities. These losses can also continue to be carried forward to offset the final capital gain on the investment.

There have been a lot of claims and counter claims about negative gearing. What we do know for sure is:

- Many average Australian taxpayers own a negatively geared property.
- However the bulk of the tax savings in dollar terms are achieved by high income earners.
- The strategy is particularly effective because the loss offsets income earned at the (higher) marginal rates whereas the (hoped for) capital gain is taxed at concessional rates. It thus allows taxpayers to subvert the progressivity in the marginal tax rate regime.

- This might not be a bad thing if the economy is benefiting more than the loss in government revenue and the inequity concerns are dismissed.

- Whilst there is some evidence that negative gearing helps lower rents, rents are largely determined by demand and supply.

- Additionally, negative gearing serves to push up house prices (by 2% it is estimated).

- Investment in existing houses is less productive investment from the perspective of the economy.

- Many other countries have some restrictions on negative gearing.

Capital gains tax

Capital gains discount for all assets purchased after 1 July 2017 reduced to 25%. All investments made before this date not affected by this change.

The CGT discount will not change for small business assets nor superannuation funds.

Superannuation

Labor's superannuation proposals are twofold:

1. Reduce the tax-free concession available to people with annual superannuation incomes from earnings of more than $75,000. From 1 July 2017, earnings on assets supporting income streams will be tax-free up to $75,000 a year for each individual. Earnings above the $75,000 threshold will attract the same concessional rate of 15% that applies to earnings in the accumulation phase. Applicable only where superannuation balances in excess of $1.5 million.

The 10% tax offset for defined benefit income above $75,000 would also be removed.

2. Reduce the Higher Income Superannuation Charge threshold from $300,000 to $250,000.

International Tax Avoidance

Proposals include:

- amending the thin capitalisation rules to limit the amount of debt deductions MNCs can claim in Australia to the debt-to-equity ratio of a company's entire global operations (ie no other safe harbor such as the 1.5:1 ratio for non-AFIs).

- aligning Australia's tax treatment of hybrid entities and instruments with those of foreign countries to reduce the opportunity for companies to claim tax exemptions and deductions in more than one country.

- providing additional funding to the ATO to properly investigate and pursue MNC profit shifting.

- increasing penalties for 'significant global entities' that fail to lodge a Country-By-Country report (50 times current penalty amount of $5,400 to $270,000).

- restoring the $100 million threshold (down from $200 million) for public reporting of tax information of large Australian private companies by the ATO.

- establishing a publicly accessible central register of beneficial ownership of Australian companies, trusts and other corporate structures.

Australian angel investment scheme

To encourage investment in start-up ventures this scheme is to provide:

- an upfront 50% tax deduction for an investment up to a maximum of $200,000 per year,

- investors can 'carry back' tax relief if they do not reach the maximum $200,000 cap in any particular year,

- full CGT exemption for equity held in the startup venture for more than 3 years,

- allow realised losses following investment in the scheme to be deducted against wage and salary income, and

- defer CGT on investments if the investor directs a prior capital gain into a new startup venture.