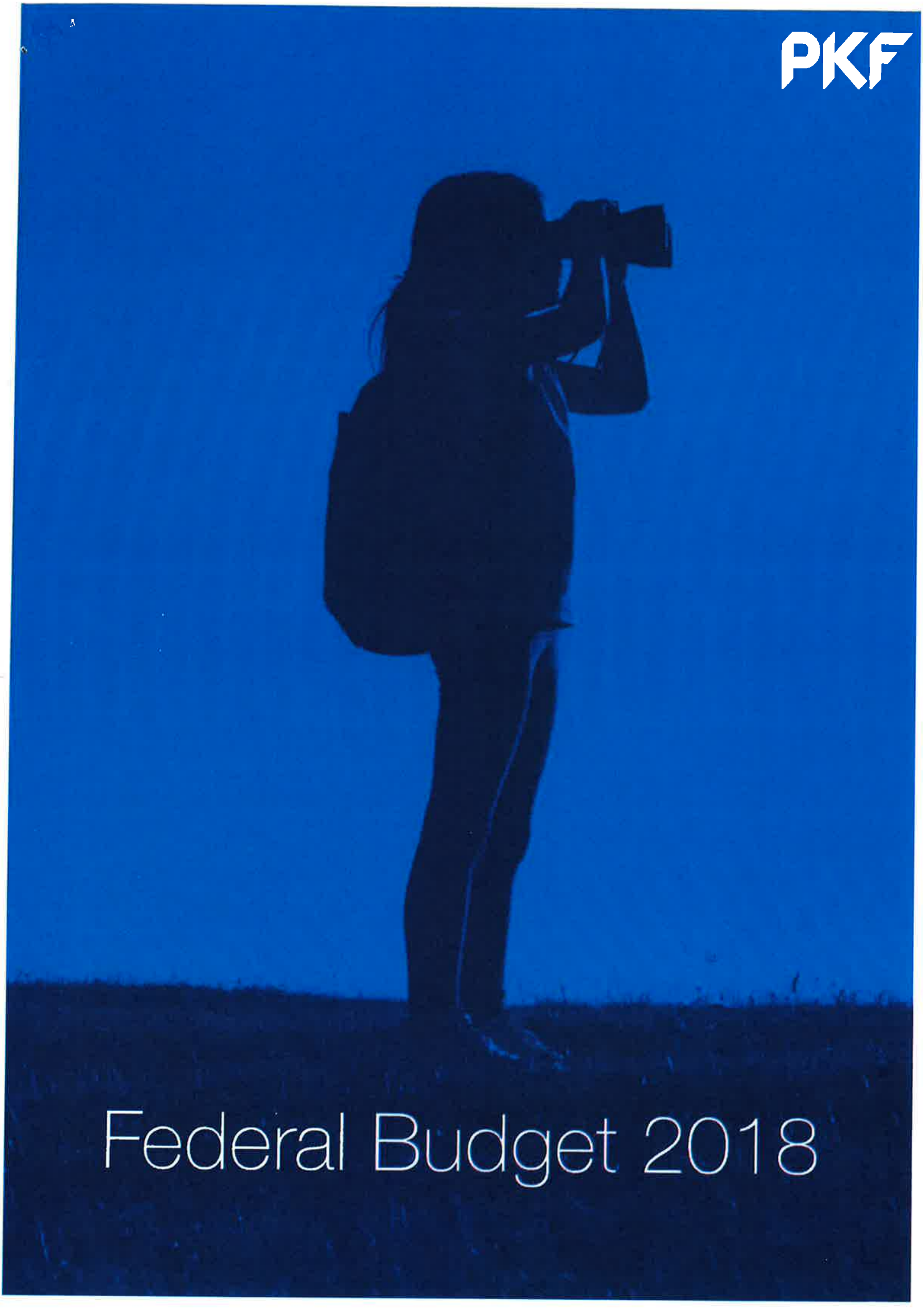

Federal Budget 2018

Introduction

PKF

Welcome to the PKF report on the third budget handed down by the Turnbull / Morrison government.

This budget is the Treasurer's last before the next Federal Election and it clearly looks to the future with measures generally in line with the Government's longer term fiscal plan.

The budget is focused on a "coming back to balance" and further strengthening of Australia's economic position, projecting a return surplus earlier than expected, in 2019-20.

With an eye on the future, the Treasurer outlined a three step personal tax reform plan commencing with modest tax cuts for middle and low income earners in the next financial year. Over the following two financial years measures to extend the 32.5% tax bracket and ultimately remove the 37% bracket will be enacted.

The government reaffirmed its support for small and medium business, extending the small business asset immediate write-off again and remaining committed to its 10-year enterprise plan, including the previously announced corporate tax cuts.

Numerous integrity measures were announced, including a tightening of the Research & Development Tax Incentive program, strengthening of Division 7A rules on the treatment of UPEs, restrictions on certain trust arrangements and the disallowance of deductions associated with vacant land and on non-compliant payments to employees and contractors.

The black economy is the primary target of the budget with additional crackdowns designed to increase reporting and monitoring of high risk sectors, further funding for ATO activity which coupled with stronger anti-phoenix laws, is expected to fund much of the incentive-based measures.

This is a budget selling a message of honesty and fairness, supporting infrastructure and new development. The biggest winners are 'average' taxpayers, drivers, small business and potentially pensioners. The biggest losers include tax cheats, criminals and foreign business. As expected though, there was little in this budget that could be labeled 'big ticket tax reform'. It is likely those measures will have to wait until after the election.

PKF AUSTRALIA TAXATION COMMITTEE
8 MAY 2018

From 1 July 2022, the low income tax offset will be increased from $445 to $645, and the 19% PIT bracket will be increased from $37,000 to $41,000 to lock in the benefits of the LMITO in Step 1. The increased low income tax offset will be withdrawn at a rate of 6.5 cents per dollar for incomes between $37,000 and $41,000, and at a rate of 1.5 cents per dollar for incomes between $41,000 and $66,667.

From 1 July 2022, the top threshold of the 32.5% PIT bracket will be further increased from $90,000 to $120,000.

Step 3: Removing the 37% personal income tax bracket

The 37% PIT bracket will be removed from 1 July 2024.

From 1 July 2024, the top threshold of the 32.5% PIT bracket will be increased from $120,000 to $200,000. Taxpayers will pay the top marginal tax rate of 45% for taxable incomes exceeding $200,000, and the 32.5% PIT bracket will apply to taxable incomes of $41,001 to $200,000. This is illustrated in the table below.

Rate	Thresholds in 2017/18	New thresholds in 2024/25
Nil	Up to $18,200	Up to $18,200
19%	$18,201 – $37,000	$18,201 – $41,000
32.5%	$37,001 – $87,000	$41,001 – $200,000
37%	$87,001 – $180,000	–
45%	Above $180,000	Above $200,000

Medicare levy – low income thresholds to increase

The Medicare levy low-income thresholds for singles, families, seniors and pensioners will be increased from the 2017/18 income year.

The threshold for singles will increase to $21,980 (up from $21,655 in 2016/17). The family threshold will increase to $37,089 (up from $36,541 in 2016/17). For single seniors and pensioners, the threshold will increase to $34,758 (up from $34,244 in 2016/17). The family threshold for seniors and pensioners will increase to $48,385 (up from $47,670 in 2016/17). For each dependent child or student, the family income thresholds increase by a further $3,406 (up from $3,356 in 2016/17).

Retaining the Medicare levy at 2%

The 2017/18 Federal Budget measure to increase the Medicare levy from 2% to 2.5% of taxable income from 1 July 2019 will not proceed.

Consequential changes to other tax rates that are linked to the top personal income tax rate, such as the fringe benefits tax rate, will also not proceed.

Income tax exemption for certain veteran payments

Supplementary amounts (such as pension supplement, rent assistance and remote area allowance) paid to a veteran, and full payments (including the supplementary component) made to the spouse or partner of a veteran who dies, are exempt from income tax from 1 May 2018.

Income tax

R&D tax incentive changes

The calculation for entities claiming the R&D tax incentive will change commencing for income years beginning on or after 1 July 2018. Also, a maximum cash refund for "smaller" R&D claimants will be capped at $4m per financial year. A "smaller" R&D claimant is an entity with aggregated annual turnover below $20m.

The changes for calculating the R&D tax incentive are based around an "R&D intensity percentage" for each entity. The R&D intensity percentage is based on the amount of R&D related exenditure as a percentage of total company expenditure. The lower the R&D intensity percentage for the entity, the lower the maximum available tax offset.

Currently there is a limit on which a company can claim the accelerated rates for the R&D tax incentive. Above this limit, the R&D tax incentive can still be claimed but only at the entity's corporate tax rate. It is proposed in the budget that the maximum eligible expenditure to get the concessional rates will rise from $100m per entity per year to $150m.

PKF Comment

Going forward, companies need to develop a meaningful R&D strategy that links to specific market opportunities and builds their IP assets into a long term and bankable competitive advantage to compete on a global stage. Innovation continues to underpin the creation of economic value for SMEs. The Government continues to support R&D but this support is not unlimited.

Companies with annual turnover above $20m

Currently: A 38.5% non-refundable tax offset is available with a minimum eligible R&D expenditure of $20,000 pa.

Proposed: Four levels of non-refundable tax offset based on an R&D intensity percentage and the entity's corporate tax rate.

- 40% or 42.5% offset if more than 10% of total expenditure relates to R&D
- 36.5% or 39% offset if R&D intensity percentage is between 5% and 10%
- 34% or 36.5% offset if R&D intensity percentage is between 2% and 5%
- 31.5% or 34% offset if R&D intensity percentage is between 0% and 2%.

The current "lock out" laws for simplified depreciation rules, which prevent small businesses from re-entering the pooling rules for five years if they opt out, will continue to be suspended until 30 June 2019.

PKF Comment

This is a welcome change for small business entities with an aggregate turnover of less than $10 million. The extension to 30 June 2019 and the turnover will allow a significant number of small business entities to access the instant asset write-off. However, cash flow will be a key indicator for the small business entities and whether or not they utilise this measure.

Tax integrity — Div 7A UPE rule strengthened; major reform delayed

Division 7A of ITAA 1936 will be amended to clarify the circumstances in which it applies to unpaid present entitlements (UPEs) — where a related private company becomes entitled to a share of trust income as a beneficiary, but has not been paid that amount. The amendments will apply from 1 July 2019.

Division 7A is an integrity rule that requires benefits provided by private companies to related taxpayers to be taxed as dividends unless they are structured as Div 7A complying loans or another exception applies. This measure will ensure the UPE is either required to be repaid to the private company over time as a complying loan or subject to tax as a dividend.

The start date of targeted amendments to Div 7A will be deferred from 1 July 2018 to 1 July 2019. Those reforms, announced in the 10-Year Enterprise Tax Plan in the 2016/17 Budget, will enable all Div 7A amendments to be progressed as part of a consolidated package.

PKF Comment

Dealing with loans from private companies continues to cause compliance difficulties with no sign of the previously promised simplifications to this regime. The need for such measures are likely to continue as the gap between corporate tax rates and individual tax rates grows over time as a result of the Government's proposed tax cuts for businesses.

Tax integrity — deductions for vacant land to be denied

From 1 July 2019, tax deductions will not be allowed for expenses associated with holding vacant land. This is an integrity measure to address concerns that deductions are being improperly claimed for expenses, such as interest costs related to holding vacant land where the land is not genuinely held for the purpose of earning assessable income. It will also reduce tax incentives for land banking, which deny the use of land for housing or other development.

The measure will apply to land held for residential or commercial purposes. However, the "carrying on a business" test will generally exclude land held for commercial development.

Deductions that are denied will not be able certain payments to contractors which have not met PAYG obligations will be removed. Currently, if a contractor does not quote an ABN in a business-to-business transaction, the purchaser is required to withhold an amount at the top marginal tax rate and remit this amount to the ATO. Failure to do this correctly will render the entire payment non-deductible.

Both of these measures will take effect from 1 July 2019.

PKF Comment

Perhaps triggered by the recent Plutus payroll case and improvements data-matching capabilities, businesses who fail to withhold appropriately from payments will not be entitled to a deduction. Although this measure sounds significant, the anticipated small gain to revenue over the forward estimate periods indicates that the Government believes the vast majority of businesses are doing the right thing in this regard.

Company tax — significant global entity definition broadened

The definition of a "significant global entity" (SGE) will be amended to include members of large multinational groups headed by private companies, trusts and partnerships. It will also include members of groups headed by investment entities.

The current definition applies only to an entity which is a member of a group headed by a public company or a private company required to provide consolidated financial statements.

The measure will also ensure the Commissioner's power to determine an entity to be an SGE parent operates as intended.

The SGE definition identifies entities which are required to prepare country-by-country (CbC) reports, and is used to determine entities which may be subject to Australia's multinational tax integrity rules, such as the multinational anti-avoidance law (MAAL) and the diverted profits tax (DPT).

The measure will apply to income years commencing on or after 1 July 2018.

Tax integrity — tightening of thin capitalisation rules

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

the deceased estate, or the proceeds of the disposal or investment of those assets.

Currently, income received by minors from testamentary trusts is taxed at normal adult rates rather than the higher tax rates that generally apply to minors. However, some taxpayers are able to inappropriately obtain the benefit of this lower tax rate by injecting assets unrelated to the deceased estate into the testamentary trust. The measure will clarify that minors will be taxed at adult marginal tax rates only in respect of the income a testamentary trust generates from assets of the deceased estate (or the proceeds of the disposal or investment of these assets).

Income tax exemption for International Cricket Council

A five year income tax exemption will be provided to a subsidiary of the International Cricket Council (ICC) for the ICC World Twenty20 to be held in Australia in 2020. The exemption will apply from 1 July 2018 to 30 June 2023. The subsidiary will also be provided an exemption from interest, dividend and royalty withholding tax liabilities for the same period.

International tax — list of information exchange countries to be updated

The government will update the list of countries whose residents are eligible to access a reduced withholding tax rate of 15%, instead of the default rate of 30%, on certain distributions from Australian managed investment trusts (MITs). Listed countries are those which have established the legal relationship enabling them to share taxpayer information with Australia.
The update will add the 56 jurisdictions that have entered into information sharing agreements since 2012.

This measure supports the operation of the MIT withholding tax system by providing the reduced withholding tax rate only to residents of countries that enter into effective information sharing agreements with Australia.

The updated list will be effective from 1 January 2019.

Deductible gift recipients list updated

Since the Mid-Year Economic and Fiscal Outlook 2017/18, the following organisations have been approved as specifically-listed deductible gift recipients for the following dates:

- Paul Ramsay Foundation Ltd from 1 July 2018 to 30 June 2020
- Australian Women Donors Network from 9 March 2018 to 8 March 2023
- Victorian Pride Centre Ltd from 9 March 2018 to 8 March 2023
- Smile Like Drake Foundation Ltd from 9 March 2018 to 8 March 2023
- Australian Sports Foundation Charitable Fund from 1 July 2018 to 30 June 2023, and
- Q Foundation Trust from 1 January 2018 to 31 December 2022.

that SMSF trustees maintain regular communication with our SMSF specialist team to identify and resolve any compliance issues at the earliest possible opportunity.

Preventing inadvertent concessional cap breaches

Individuals whose income exceeds $263,157, and have multiple employers, will be able to nominate that their wages from certain employers are not subject to the superannuation guarantee (SG) from 1 July 2018. The measure is intended to ensure eligible individuals can avoid unintentionally breaching the $25,000 annual concessional contributions cap as a result of multiple compulsory SG contributions. Breaching the cap results in individuals being liable to pay excess contributions tax and a shortfall interest charge. Employees using this measure may receive additional income which will be taxed at marginal tax rates.

PKF Comment

As the adage goes 'failing to plan is planning to fail'. Employees will be able to forward plan and work with their various employers to avoid unintentional breaches of the concessional contributions cap and negotiate to receive marginally taxed income instead.

Improving integrity of personal contributions deductions

Individual income tax returns will be modified to include a tick box for individuals with personal superannuation contributions to confirm that they have complied with the requirements to submit a "notice of intent" (NOI) where they intend to take a tax deduction for the contributions.

The change is intended to improve the integrity of the NOI processes for claiming personal superannuation contribution tax deductions. Where individuals take deductions for their personal superannuation contributions, but do not submit the required "notice of intent", it results in superannuation funds not applying the 15% tax to their contribution and no tax is paid on it.

The ATO will receive additional funding to develop a new compliance model, and to undertake additional compliance and debt collection activities, including denying deductions to individuals who do not comply with the NOI requirements.

Black economy measures

Reforms to combat illegal phoenixing and black economy

The government will reform the corporations and tax laws and provide the regulators with additional tools to assist them to deter and disrupt illegal phoenix activity. The package includes reforms to:

- introduce new phoenix offences to target those who conduct or facilitate illegal phoenixing
- prevent directors improperly backdating resignations to avoid liability or prosecution
- limit the ability of directors to resign when this would leave the company with no directors
- restrict the ability of related creditors to vote on the appointment, removal or replacement of an external administrator
- extend the Director Penalty Regime to GST, luxury car tax and wine equalisation tax, making directors personally liable for the company's debts, and
- expand the ATO's power to retain refunds where there are outstanding tax lodgements.

Additional funding to the ATO will also be provided over four years to implement new strategies to combat the black economy. The ATO will implement a new and enhanced enforcement strategy that brings together new mobile strike teams and an increased

audit presence, a Black Economy Hotline that will allow for the community to report black economy and illegal phoenix activities, improved government data analytics, and educational activities.

The government will also consult on and design a new regulatory framework for the Australian Business Number (ABN) system in 2018/19. This measure implements a recommendation of the Black Economy Taskforce – Final Report that the ABN system be strengthened to provide improved confidence in the identity and legitimacy of Australian businesses.

Taxable payments reporting system to be expanded

The taxable payments reporting system (TPRS) will be expanded to the following industries from 1 July 2019:

Indirect taxes

GST to be extended to offshore hotel accommodation sellers

Offshore sellers of hotel accommodation in Australia will be required to calculate their GST turnover in the same way as local sellers from 1 July 2019.

Currently, unlike GST-registered businesses in Australia, offshore sellers of Australian hotel accommodation are exempt from including sales of hotel accommodation in their GST turnover. This means that they are often not required to register for and charge GST on their mark-up over the wholesale price of the accommodation.

Removing the exemption will level the playing field by ensuring the same tax treatment of Australian hotel accommodation, whether booked through a domestic or offshore company.

The measure will apply to sales made on or after 1 July 2019. Sales that occur before 1 July 2019 will not be subject to the measure even if the stay at the hotel occurs after this date. This change will require the unanimous agreement of the states and territories prior to the enactment of legislation.

This measure follows the extension of GST to digital products and other services from 1 July 2017, and to low value imported goods from 1 July 2018.

PKF Comment

As the net of the 'Netflix Tax' broadens, offshore hotel accommodation sellers of hotel accommodation in Australia will be impacted by the proposed measure. This will see an increase in compliance costs and administrative burden for inbound businesses. The measure is aimed at levelling the playing field for local businesses if a robust collection mechanism is implemented.

Removal of luxury car tax on re-imported cars following refurbishment overseas

The luxury car tax on cars re-imported into Australia, following a refurbishment overseas, will be removed from 1 January 2019.

Currently, cars that are refurbished in Australia are not subject to luxury car tax. However, cars exported from Australia to be refurbished overseas and then re-imported are subject to the tax where the value of the car exceeds the relevant luxury car tax threshold.

ATO excise systems upgrade

The ATO will upgrade and modernise its excise and excise equivalent goods payment systems from 2020/21 to replace the paper lodgement system.

Customs duty on imported placebos and clinical trial kits to be removed

Customs tariffs from placebos and clinical trial kits that are imported into Australia will be removed from 1 July 2018.

This measure will simplify the import process for clinical trial kits and placebos, removing the need to differentiate between medicines and placebos, as both will now be subject to a free rate of duty.

Access to Indirect Tax Concession Scheme extended

Access to refunds of indirect tax, including GST, fuel and alcohol taxes under the Indirect Tax Concession Scheme has been extended. New access to refunds will be granted to the diplomatic and consular representations of Cote d'Ivoire, Guatemala, Costa Rica and Kazakhstan in Australia.

Each of these changes has effect from a time specified by the Minister for Foreign Affairs.