A changing tax landscape?

Insights from the announced Government and Opposition tax policies

With a Federal election looming, we reflect on the policies announced by both the Federal Government and Australian Labor Party to consider what the forward tax agenda might look like and how this may impact business.

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Overview

Treasurer Josh Frydenberg handed down the 2019 – 2020 Federal budget on 2 April 2019 revealing a clear policy agenda by the Government. Subsequently, on 4 April 2019, the Opposition leader Bill Shorten delivered the Budget-in-reply address which confirmed a series of Labor's tax policies.

With a Federal election to be called shortly, 'Budget week' defined the policy differences between both major parties. This report explores the tax policies announced by both sides as we head into the next election and how this might impact business.

Corporate tax

Overview

The proposals from both parties draw identifiable differences in policy intent. The Government is focused on the increased expansion of the ATO Tax Avoidance Taskforce, reflective of their position to ensure compliance within the tax system and raise tax revenue.

The Opposition, taking a different stance, see the need to ensure reform by making franking credits no longer refundable to certain individuals and superannuation funds, in a bid to close loopholes and aid in the delivery of improving the budget's bottom line.

Federal Budget

Policy: Extension and expansion of the ATO Tax Avoidance Taskforce

Measure: The Government will provide an additional $1 billion over four years from 2019 - 2020 to the ATO to extend the operation of the Tax Avoidance Taskforce and to expand the Taskforce's programs and market coverage. This is a significant increase from funding provided to the Taskforce at its inception following the 2016 Budget. At that time, the Government had previously funded the Taskforce with $679 million over four years. As a result, the ATO has reported a collection of over $5.6 billion in tax in its first two years of operation. The Government has specifically noted that this measure will allow the Taskforce to expand these activities, including increasing its scrutiny of specialist tax advisors and intermediaries that promote tax avoidance schemes and strategies.

Opposition Policies

Policy: Proposed changes to dividend imputation

Measure: Australia's dividend imputation system was introduced by Paul Keating in 1987 to eliminate double taxation on dividends from company profits. Currently shareholders can use imputation credits to reduce their overall tax liability. Under this regime a concession exists to allow some individuals and superannuation funds to receive a cash refund from the ATO if their imputation credits exceed the tax otherwise payable. It has been announced, that if elected, Labor will close down the concession created by the Howard and Costello government, and return to the arrangement first introduced by Hawke and Keating. Endorsed income tax exempt charities and not-for-profit institutions with deductible gift recipient status are proposed to be excluded from this measure. This proposed measure is to apply from 1 July 2019.

Policy: Changes to the company income tax rate

Measure: Labor have confirmed that they will maintain the legislated company tax rate reduction to 25% by 2021-2022 for small and medium sized-business with aggregated turnover of up to $50 million.

> "If the tax office pays a credit to someone who pays no tax, this is a gift
>
> *Budget-in-reply address*"

MinterEllison insights

The significant expansion in funding now provides the ATO with the resources to enforce several integrity measures which have been introduced over the last few years with a clear intent to close the corporate tax gap. It remains to be seen what the ATO's approach will be with this additional resource, and whether it will be emboldened, as it now appears other regulators are to litigate first.

Whilst the increase in funding from the ATO might well be expected to receive bipartisan support, it is clear that Labor's proposal for removal of refundable franking credits will not receive support from the Coalition. It would appear that the proposed removal would have a significant adverse impact on those superannuation funds whose investment base comprises primarily of Australian shares, whilst those whose investment base are more diverse among asset classes may not have any material impact.

Personal tax

Overview

Both the Government and Opposition propose to cut taxes for middle income earners. This commitment is expected to be well received as it offers immediate tax relief, regardless of who wins the next election, and may be effective as soon as Australians lodge their next tax return. However the Opposition has outlined further tax reform with respect to key tax items that affect individuals, including negative gearing and reduction of the CGT discount.

Federal Budget

Policy: Personal income tax cuts: Personal Income Tax Plan

Measure: The Government announced that it will extend the Personal Income Tax Plan **(PITP)** relief as follows.

Step 1:
Introduction of the Low and Middle Income Tax Offset

The Low and Middle Income Tax Offset **(LMITO)** was introduced as a non-refundable tax offset available for the income years ending 30 June 2019 to 30 June 2022. The offset depends on the amount of taxable income earned by an individual taxpayer in a given income year.

The Government will provide for a further reduction in tax provided through the LMITO by increasing the available offset so that:

- for taxable income of $37,000 or less, an LMITO of $255 will be available;
- between taxable incomes of $37,000 and $48,000, the LMITO will increase at a rate of 7.5 cents per dollar up to the maximum offset of $1,080;
- between taxable incomes of $48,000 and $90,000, a maximum offset of $1,080 will be available; and
- for taxable incomes of $90,000 to $126,000, the offset will phase out at a rate of 3 cents per dollar.

The LMITO will be available via assessment after individuals lodge their tax returns for the income years ending 30 June 2019 to 30 June 2022, at which point the LMITO will be replaced by the changes discussed at Step 2 below.

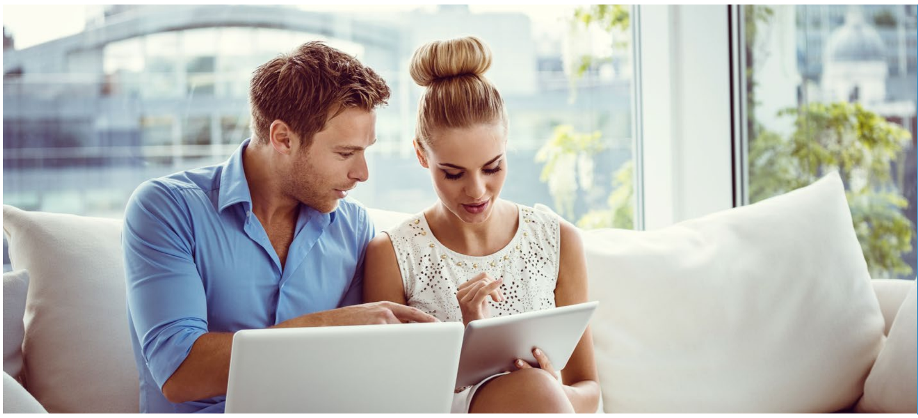
Step 2:
Bracket creep relief for middle income earners

The following changes are proposed to Step 2 of the PITP:

1. From 1 July 2022, the 19% personal income tax bracket will apply to taxable income between **$18,200 and $45,000,** instead of $18,200 and $41,000, as currently legislated; and
2. The new Low Income Tax Offset **(LITO)** will be increased from $645 to $700. The increase will now be withdrawn at a rate of 5 cents per dollar between taxable incomes of $37,500 and $45,000, instead of at 6.5 cents per dollar between taxable incomes of $37,000 and $41,000 as currently legislated under the PITP. The LITO will then be withdrawn at a rate of 1.5 cents per dollar between taxable incomes of $45,000 to $66,667.

Step 3:
Simpler personal income tax system

The Government now proposes to go one step further than the original PITP by lowering the existing 32.5% rate to 30%. As a result, from 1 July 2024, a tax bracket of 30% will apply to taxable income between **$41,001 and $200,000.** The top marginal tax rate of 45% (unchanged from the current top marginal tax rate) will apply to taxable income exceeding $200,000.



> "Providing immediate relief to address the cost of living pressures"
>
> *Federal Budget*

> We cannot have property investors playing with loaded dice against our young people, Generation Y and the Millennials
>
> *Budget-in-reply address*

Policy: Increase to the Medicare levy for low-income thresholds

Measure: The Government proposes to increase the Medicare levy thresholds for singles, families and pensioners to account for recent movements in the Consumer Price Index.

Broadly the thresholds will be increased as follows:

Singles: From $21,980 to $22,398

Families: From $37,089 to $37,794

Single seniors and pensioners: $34,758 to $35,418

Opposition Policies

Proposed changes to negative gearing

Labor has confirmed that, if elected, they will proceed with the plan to limit negative gearing to newly constructed residential properties.

All investments made before 1 January 2020 will be protected by grandfathering arrangements.

Labor's policy in respect of negative gearing suggests that losses from new investments other than new residential properties will not be able to be applied against salary and wage income. Deductions against investment income, will be able to be carried forward in order to offset any gain from the disposal of the investment that may occur at a future date.

This proposal would take effect from 1 January 2020.

Policy: Proposed changes to the CGT discount

Measure: Labor has proposed to reduce the general CGT discount for individuals and trusts from 50% to 25% for assets acquired from 1 January 2020. The CGT discount is currently available for investments held for more than 12 months on capital account. The intention of Labor is to grandfather existing investments. The proposed change to the CGT discount is not intended to apply to superannuation funds and small business assets.

Policy: 'Build to Rent'

Measure: Labor has announced that it will reform the tax treatment for 'Build to Rent'. 'Build to Rent' housing is proposed to be included within a Managed Investment Trust, where they meet requirements that are currently in place for commercial property assets (ie. where they are a passive investment held primarily for the purpose of deriving rent). Eligible Build to Rent investments will pay a 15% tax rate.

Policy: Change to marginal tax rates for individuals

Measure: With the current top marginal tax rate at 47% (inclusive of the Medicare levy), Labor proposes to lift the top marginal rate of tax to 49%, an increase of 2%, similar to the Budget Repair Levy that ceased to apply from 1 July 2017. Labor proposed in their Budget reply that they would be offering greater personal tax cuts in a bid to flatten tax rates.

Policy: Deductibility of managing tax affairs

Measure: Labor has proposed a $3,000 limit on the amount that individuals are able to deduct from their assessable income in relation to the management of their tax affairs.

MinterEllison insights

Labor's proposed changes to reduce the CGT discount and to quarantine losses made through negative gearing will have a significant impact on investments in the property market, resulting in a potential reduction in investor activity leading to downward pressure on house prices and a reduction in the practice of margin lending. Both changes apply after 1 January 2020 with investments made before that time being protected by grandfather arrangements. Post 1 January 2020, the proposed amendments to negative gearing will only apply to investments in existing property. To encourage housing construction, investors in new-builds will still enjoy the concession.

Individuals seeking to utilise negative gearing and capital tax concessions would be encouraged to make their investments before 1 January 2020. Post 1 January 2020, property investors would need to reconsider their investment strategy and whether they would benefit from investing in newly constructed residential properties over existing properties. As the policy change on the CGT discount does not affect investments made by superannuation funds (who will continue to receive their discount at 33%), we anticipate investments from superannuation funds in property to grow to obtain the full benefit of the CGT discount.

Private business

Overview

Both parties are offering relief to businesses through the changes to the tax treatment of assets. The Federal Government immediately expanded the threshold for the instant asset write-off to $30,000 intended to improve cash flow for small and medium sized businesses, while boosting spending and investment. Labor has proposed an investment guarantee policy aimed at assets valued above $20,000.

Federal Budget

Policy: Expansion of instant asset write-off

Measure: Announced in the Federal Budget and passed through the Senate on 3 April 2019, the instant asset write-off is now extended to medium sized businesses and the threshold increased from $25,000 to $30,000 per asset.

The new threshold will apply to small businesses with aggregated turnover of up to $10 million from 2 April 2019 until the end of the measure on 30 June 2020. The existing threshold of $25,000 continues to apply to assets that are first used, or installed ready for use prior to 2 April 2019.

Medium businesses with turnover between $10 million and $50 million will gain access to the instant asset write-off for assets up to the threshold of $30,000 that are first used, or installed ready for use, from 2 April 2019 to 30 June 2020.

Policy: Amendments to Division 7A deferred

Measure: We reported in last year's Budget update that a measure was announced to clarify the operation of the Division 7A integrity rule with effect from 1 July 2019.

Since then, the Government released a consultation paper seeking feedback from stakeholders. The feedback highlighted that Division 7A is a complex area of the tax law and raised implementation issues warranting further consideration.

On this basis, this year's Budget announced that any amendments to Division 7A will be deferred until 1 July 2020 to allow for further consultation and to refine the Government's approach to Division 7A.

Given the uncertainty around the potential changes to Division 7A (and the fast approaching year-end), the deferral of the effective date of any changes is welcomed.

> "Small businesses are the engine-room of our economy"
>
> *Federal Budget address*

Opposition Policies

Policy: Proposed changes to discretionary trusts

Measure: Labor has proposed a minimum 30% tax rate for discretionary trust distributions to people over the age of 18.

Discretionary trusts generally allow for trust income to be distributed on an entirely discretionary basis to beneficiaries who maybe on differing tax rates (including less than 30%).

Labor's policy will only apply to discretionary trusts. Non-discretionary trusts such as special disability trusts, deceased estates and fixed trusts will not be affected by the change. The policy will also not apply to farm trusts and charitable trusts.

The proposed change by Labor is to tackle the perceived use of income splitting to minimise tax, which Labor assumes will make the tax system fairer and improve the Budget's bottom line.

The policy is proposed to apply from 1 July 2019.

Policy: Australian Investment Guarantee (AIG)

Measure: Under Labor, the AIG will allow all businesses to immediately deduct 20% of any new eligible assets worth more than $20,000, with the balance depreciated in line with the normal depreciation schedules from the first year. Eligible assets include tangible and intangible assets.

The AIG is proposed to apply from 1 July 2021.

Policy: Tax transparency – changes to reporting threshold

Measure: Labor proposes to lower the reporting threshold for tax transparency data for private firms from $200 million to $100 million. This is expected to lead to publicly released data for another 600 large private groups. The publicly released data includes disclosures of accounting income, taxable income and tax payable.

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MinterEllison insights

Labor's policy to propose a minimum 30% tax rate for discretionary trust distributions seeks to align with the corporate tax rate of 30% (other than base rate entities which are currently taxed at 27.5%). This is on the basis that those able to split their income through a family trust are typically carrying on some form of business that could be equally carried on by a corporate. As a consequence we anticipate that depending on the situation, there may be a shift to transitioning what would otherwise be trust structures, to companies (especially if potentially, the company is a base rate entity).

The AIG is Labor's direct response to the Coalition's instant asset write off and seeks to encourage new investments. Eligible assets would include machinery, plant and equipment (but not buildings) and intangible investments such as patents and copyright.

We also see the decrease in the threshold for the reporting of tax transparency data for private groups leading to increased compliance costs for a large number of private groups, adding a greater burden in an already highly regulated corporate environment.

Clients that are now within the lower threshold for the reporting of tax transparency data, should seek advice on the impact on data that it now is required to disclose to the public and to manage compliance costs in respect of the disclosure.

Clients currently operating their business through a discretionary trust structure may need to revisit their overall operating structure.

Clients seeking to obtain the full benefit of the AIG will need to keep proper records to evidence the availability of the AIG for investments in assets worth more than $20,000.

> "We will provide an extra 20% tax break for every business that invests in productivity-boosting equipment above $20,000 – whether that's a big manufacturer buying new technology, or a tradie getting a new ute"
>
> *Budget-in-reply address*

Global tax

Overview

Is Australia still an attractive place to do business?

The Government's proposed changes see the introduction of a new tax treaty and the simplification of complex integrity rules. Distinctively, the Opposition's proposed policy considers changes to the thin capitalisation regime, MEC groups and Country by Country (CbC) reporting. The question is how foreign investors will view these policies?

Federal Budget

Policy: Australian Managed Investment Trusts (MITS) – Updated list of info exchange countries

Measure: The Government has announced that they will update the list of countries whose residents are able to access the reduced MIT withholding tax rate by adding the following countries to the 114 other jurisdictions on the list: Curacao, Lebanon, Nauru, Pakistan, Panama, Peru, Qatar and the United Arab Emirates.

The updated list will be effective from 1 January 2020.

Policy: New Australia – Israel tax treaty

Measure: The Australia Israel tax treaty (DTA) was signed on 28 March 2019. The DTA will enter into force, subject to the domestic requirements of each jurisdiction for the passage of legislation. The DTA will enter into effect on the next occurring 1 January for withholding taxes, 1 April for Fringe Benefits Taxes, and 1 July for all other taxes after the DTA enters into force.

The DTA adopts many of the measures set out in the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to prevent Base Erosion and Profit Shifting **(MLI)**.

Policy: Tax Integrity – clarifying the operation of the hybrid mismatch rules

Measure: The recently enacted hybrid mismatch rules are a complex set of integrity measures which contain several issues requiring clarification which the Government has now attempted to address. Specific details remain limited, however our observations are that the amendments will:

- **Confirm that the rules will apply to multiple entry consolidated (MEC) groups and trusts:** The clarification on how the hybrid mismatch rules will apply to MEC groups and trusts appear to be directed to ensuring that the Base Erosion and Profit Shifting initiative implemented by the OECD (the initiative from which the hybrid mismatch rules are derived) applies to all types of entities that comprise the Australian tax system.
- **Limit the meaning of foreign tax:** Currently the hybrid mismatch rules do not provide a definition of the meaning of "foreign tax", which creates uncertainty in determining the scope of these provisions when analysing foreign tax outcomes. It remains to be seen how this new definition might operate.
- **Allow the application of the integrity rule where other provisions have applied:** The integrity rules do not provide guidance on how they interact with other integrity provisions in the Australian tax law. The announced amendment appears directed to clarifying that the integrity measure will also apply even if other measures also have application to the relevant circumstances.

It is proposed that the amendments will apply to income years starting on or after 1 January 2019. The amendments to the integrity measure will apply to income years starting on or after 2 April 2019.

> "Our tax system will remain highly progressive"
>
> *Federal Budget address*

> "Reforming the tax system so that it is fair for everyone"
>
> *Budget-in-reply address*

Opposition Policies

Policy: Proposed changes to the thin capitalisation rules

Measure: A thinly capitalised entity is one whose assets are funded by a high level of debt and relatively little equity.

Currently, the thin capitalisation provisions operate to deny debt deductions for foreign controlled entities and Australian entities investing overseas, where the debt-to-equity ratio exceeds a certain limit.

This limit is currently determined by the use of three tests;

1. **The safe harbour debt amount** – Limits debt used to 60% of the difference between the value of its net Australian assets and non-debt liabilities.
2. **The arm's length debt amount** – Limits the amount of debt used to an amount that one could reasonably expect to borrow on an arm's length basis from a third party.
3. **The worldwide gearing amount** – Limits the amount of debt used at a gearing level consistent with the world wide group.

Labor intends to amend the thin capitalisation rules to remove the 'safe harbour' and 'arm's length' tests for interest deductions of multinational groups. This will leave the world-wide gearing ratio as the only test to calculate the deduction available.

It is yet to be confirmed when this measure will apply.

Policy: Proposed changed to Multiple Entry Consolidated Groups (MEC groups)

Measure: MEC groups are corporate groups consisting of Australian-resident entities that share a common ultimate foreign owner, MEC groups are treated as a single tax payer for Australian income tax purposes.

Currently, MEC groups are able to retain higher cost base of assets. The result of this is there may be a reduction of a future capital gain and the enhancement of depreciation deductions, subject to the character of the asset.

Labor proposes to remove any systematic advantages available to foreign-owned MEC groups through various amendments to the current tax act governing these provisions.

Policy: Tax transparency – changes to CbC reporting

Measure: Labor has proposed the public disclosure of CbC reports lodged by multinational groups with global turnover of over $1 billion.

MinterEllison insights

Foreign investors should consider the current capitalisation of Australian operations in light of Labor's proposed amendments to Australia's thin capitalisation rules coupled with the (unspecified) reforms to the taxation of MEC groups.

These structural amendments, along with increased transparency and ATO funding may mean that foreign investors will find themselves under potential scrutiny of their arrangements in Australia.

Superannuation

Overview

No major changes were communicated by the Government with respect to the existing superannuation system.

A number of policy changes were put forward by both parties to ensure that the superannuation system operates fairly and with flexibility with respect to Australia's ageing population.

Federal Budget

Policy: Merging superannuation funds

Measure: Tax relief for merging superannuation funds to transfer revenue and capital losses to a new merged fund, and to defer tax consequences on gains and losses from revenue and capital assets is now permanent.

Policy: Superannuation contributions work test

Measure: The current work test is removed for those aged 65 and 66. The current work test requires that people aged over 65 work for a minimum of 40 hours over a 30 day period in the financial year before they can make voluntary contributions to their superannuation account. The work test will continue to apply to those aged over 66.

Policy: Non-concessional superannuation contributions

Measure: Individuals aged 65 or 66 will now be able to make up to three years of non-concessional contributions under the bring-forward rule. Those over the age of 66 are still unable to make such contributions.

Policy: Spouse contributions age limit increase

Measure: The limit will be increased to 74 years.

MinterEllison insights

The superannuation changes announced by both parties reflect their mutual intentions, to create fair access to superannuation for participants nearing retirement.

Opposition Policies

Policy: Superannuation for parental leave

Measure: Labor proposes to extend superannuation contributions to parental leave payments.

Labor has proposed that recipients of Commonwealth Paid Parental Leave and Dad and Partner Pay payments should receive superannuation contributions. Labor's policy is in response to the 40% gap in superannuation between women and men on retirement.

Policy: Changes to superannuation payment thresholds

Measure: Labor has proposed to phase out the $450 minimum monthly income threshold for eligibility for the superannuation guarantee. This recognises that the income eligibility threshold disadvantages people who work park-time, casual and in multiple low paid jobs face.

Labor has proposed to reduce the threshold by for the superannuation guarantee by $100 each year with the reduction commencing in 1 July 2020 and with a view that the threshold is reduced to zero from 1 July 2024.

Other changes:

Measure:

- Non-concessional cap to be reduced to $75,000 (currently $100,000)
- Income threshold for the extra 15% contributions tax for high income earners to be lowered to $200,000 p.a.
- Catch-up concessional contributions to be abolished.

What are the implications of the proposed policies?

The implications will be quite different depending on which party is successful in the upcoming federal election.

Tax reform is always a topical debate, encouraged to protect the prosperity of Australia by ensuring we are set up for success, enabling our country to grow in the short and long term. Amidst a return to Budget surplus as announced, a refreshed perspective on our current tax system by both parties is welcomed to ensure Australia remains competitive in a global environment.

For further information about the potential reforms, contact the MinterEllison tax team.

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