ALERT

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2016/17 Federal Budget

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Last night's Federal Budget contains important changes for small business, superannuation, individual and company tax rates, and multinationals operating in Australia. It also proposes new property and fund management vehicles and there will be further scrutiny of multinational enterprises operating in Australia, with the announcement of a Diverted Profits Tax to be imposed at a 40% tax rate.

The summary of the main changes below is designed to allow businesses to consider how the changes may impact them and what should be done in the short to medium term.

Introduction

Last night's Federal Budget contains important changes for small business, superannuation, individual and company tax rates, and multinationals operating in Australia. It also proposes new property and fund management vehicles.

Middle income earners will be assisted with a personal tax cut from 1 July 2016 so that the 37% marginal tax rate will only apply on taxable incomes from $87,000 (currently set at $80,000). Likewise, the government has sought to assist small business from 1 July 2016 by increasing the turnover test from $2 million to $10 million, allowing a greater group of small businesses to access numerous income tax concessions (with the exception of the capital gains tax concession for small business).

Small business will also be helped by the lowering of the company tax rate for qualifying companies to 27.5% from 1 July 2016. In line with international trends, the government has also made a commitment to lower the Australian company tax rate for all companies to 25% by the 2026 financial year.

Considerable media speculation existed prior to the Budget that suggested possible changes to the rules regarding superannuation. While it may be argued that the previous rules needed fine-tuning, the changes announced last night seem unduly harsh. The annual cap on deductible superannuation contributions will be lowered to $25,000; and there will be a $1.6 million cap on transfers to pension phase and a lifetime $500,000 cap on non-deductible contributions. These are just some of the negative changes to superannuation announced.

There will also be further scrutiny of multinational enterprises operating in Australia, with the announcement of a Diverted Profits Tax to be imposed at a 40% tax rate.

The summary of the main changes below is designed to allow businesses to consider how the changes may impact them and what should be done in the short to medium term.

Small business

Small business entity turnover test

The small business entity turnover test will be increased to $10 million (from $2 million), effective 1 July 2016. The higher threshold means that more businesses will be accessing the existing small business income tax concessions (some of which were introduced in the 2015/16 Federal Budget) including:

- a lower corporate tax rate of 27.5% (as compared with 30%), commencing in the 2016/17 income year;
- simplified trading stock rules, depreciation and PAYG instalment rules;
- the ability to apply the FBT exemption to portable electronic devices; and
- an immediate deduction of certain ‘start up’ expenses (eg professional advisory fees).

Importantly, the higher turnover threshold will not affect a business’ eligibility to apply the small business CGT concessions (which will remain available only to those businesses with a turnover of less than $2 million).

Unincorporated small business tax discount

The unincorporated small business tax discount (which applies to individual taxpayers with business income from an unincorporated business; eg sole traders, partnerships) will be increased to 8% on 1 July 2016. Further increases to the discount are forecasted for the 2023/24 income year onwards. The discount will also now apply to businesses with an annual turnover of less than $5 million (which has been increased from $2 million).

GST reporting for small business

All small businesses with an annual turnover of less than $10 million will be eligible to apply simplified rules in respect of classifying transactions for GST purposes and preparing and lodging business activity statements.

Reduction to corporate tax rate

The corporate tax rate will be reduced to 25% over 10 years, commencing with a reduction in the tax rate to 27.5% for businesses with an annual turnover of less than $10 million in 2016/17. The threshold for accessing the reduced corporate tax rate will then be increased progressively so that it applies to companies by 2023/24.

The 27.5% tax rate will then be further reduced annually from 2024/25 until it reaches 25% in the 2026/27 income year.

Franking credits may then be distributed in line with the rate of tax paid by the company making the distribution.

Taxation of Financial Arrangements (TOFA)

The TOFA rules will be updated with a view to increasing certainty for taxpayers and decreasing compliance costs. The reforms include:

- simplified accrual and realisation rules (which will reduce the scope of taxpayers captured by the TOFA rules);
- simplified rules for taxing gains and losses on foreign currency; and
- a new tax hedging system that covers a broader range of risk management activities.

The new TOFA rules will apply from 1 January 2018.

Adjustments to the administration of Division 7A

Targeted changes will improve the administration of Division 7A for closely held private groups. The changes include:

- a self-correction mechanism for inadvertent breaches of Division 7A;
- more clearly expressed and appropriate safe-harbour rules;
- simplified Division 7A loan arrangements; and
- various technical adjustments to improve the operation of Division 7A.

New diverted profits tax

A new 40% diverted profits tax on the profits of multinational corporations that are diverted from Australia will be introduced from the income year commencing 1 July 2017 onwards.

The new tax will target companies engaged in international profit shifting through the use of related parties where:

- the amount of tax being paid overseas is less than 80% of the amount of tax that would otherwise have been paid in Australia;
- it can be reasonably deduced that the arrangement is designed to obtain a tax benefit; and
- the arrangement does not have a sufficient commercial basis.

The tax will apply to multinational entities with a combined global revenue (ie, inclusive of subsidiaries) of at least $1 billion that either have a permanent establishment in Australia or are

Australian residents for tax purposes. Multinational entities with an annual turnover of less than $25 million may be exempt from the new tax (subject to certain conditions).

Wine equalisation tax (WET)

The WET rebate cap will be reduced to $350,000 (from $500,000), effective 1 July 2017. The WET rebate eligibility criteria will also be tightened from 1 July 2019. While the exact details of the eligibility criteria are still subject to consultation, it is anticipated that the criteria will restrict access to the WET rebate to wine producers who either own a winery or have a long term lease over a winery and sell packaged (c.f. bulk) wine domestically.

Expanded tax incentives for start-ups

To ensure that early stage innovative companies have access to capital, the government has reduced the holding period from three years to 12 months for 'angel investors' to access the 10-year capital gains tax exemption. However, the investors must not be affiliated with the innovation companies.

Personal income tax

The government has taken steps to prevent average full-time wage earners from moving into the second top tax bracket until 2019-20 by increasing the 32.5% tax threshold from $80,000 to $87,000. This will prevent around 500,000 taxpayers from facing the higher 37% marginal tax rate.

Superannuation

The government has introduced a range of measures designed to increase flexibility, access and choice for some superannuation members while removing some concessions enjoyed by high income earners and members with large account balances. These measures include:

- The introduction of a $1.6 million limit on transfers to pension phase (a tax will be applied to amounts transferred in excess of this cap similar to the excess contributions tax). Members with pension account balances currently over $1.6m will be required to reduce the balance to $1.6m by 1 July 2017. Excess balances for those members may be converted to accumulation phase.
- The lifetime non-concessional cap will apply from 1 July 2017 and will replace the annual cap of $180,000.
- The concessional contributions cap will be reduced to $25,000 annually. This cap will apply to all people, up to age 75. In addition to the reduction in the contributions cap, the threshold at which Division 293 (the point where high income earners pay additional contributions tax) imposes the 15% contributions surcharge tax will be reduced from $300,000 to $250,000 of adjusted taxable income.
- A Low Income Superannuation Tax Offset (LISTO) will reduce tax on superannuation contributions for low income earners. The LISTO will provide a non-refundable tax offset to superannuation funds, based on the tax paid on concessional contributions made on behalf of low income earners, up to a cap of $500.
- From 1 July 2017, all individuals up to age 75 will be allowed to claim an income tax deduction for personal superannuation contributions.
- From 1 July 2017, there will be increased access to the low income spouse superannuation tax offset, when the income threshold for the low income spouse is raised to $37,000 from $10,800.
- From 1 July 2017, the work test for taxpayers aged 65-74 will be removed.
- From 1 July 2017, individuals will be allowed to make additional concessional contributions where they have not reached their concessional contributions cap in previous years.

- From 1 July 2017, the income tax exemption for assets used to fund transitions to retirement income streams will be removed.
- Anti-detriment payments will be removed.

International and multinational taxation

The government proposes to introduce measures to reduce the availability of international profit-shifting and tax avoidance by:

- enforcing existing laws;
- amending transfer pricing rules contained in Division 815 of the *Income Tax Assessment Act 1997* (Cth), with effect from 1 July 2016 to ensure consistency with the OECD's Transfer Pricing Guidelines;
- introducing a new Diverted Profits Tax to impose a 40% penalty rate of tax on large multinationals (turnover of more than $1 billion) that attempt to shift their Australian profits offshore to avoid paying tax;
- a new Tax Transparency Code requiring businesses with an annual turnover of $100 million or more to publish information about their tax affairs; and
- supporting new measures announced in the 2016/17 Budget with additional funding to the ATO to establish a new Tax Avoidance Taskforce, which will have a mandate to pursue tax avoidance by multinationals and high wealth individuals.

The government also seeks to introduce measures to increase the maximum penalty from $4,500 to $450,000 for firms with global incomes of over $1 billion who fail to lodge tax returns and similar tax documents on time.

Funds management and investment

The government seeks to introduce a range of measures to provide greater flexibility to the funds management and investment/private equity industry. This includes new arrangements for venture capital investment 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 $100 million to $200 million for new early-stage venture capital limited partnerships (ESVCLPs) to also apply to existing ESVCLPs; and
- ensure that the venture capital tax concessions are available for FinTech, banking and insurance related activities.

The government will seek to introduce a new tax and regulatory framework for two new types of collective investment vehicles (CIVs), which are commonplace investment vehicles internationally. A corporate CIV will be introduced for income years starting on or after 1 July 2017. This will be followed by a limited partnership CIV 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.

The government will also seek to implement a regulatory framework for Australia's participation in the Asia Region Funds Passport. The Asia Region Funds Passport initiative aims to increase access for Australian fund managers to growing Asian markets by creating a regulatory arrangement for the cross border offer of collective investment vehicles.

Queries

Should you have any queries in relation to this alert, please contact Michael Kohn, Partner and Head of Revenue on +61 3 9608 2273 or at m.kohn@cornwalls.com.au or Dennis Tomaras, Partner, Revenue on +61 3 9608 2189 or at d.tomaras@cornwalls.com.au

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