BUDGET 2016

Insights and analysis into the Federal Budget 2016 / 17 announcement on 3 May 2016

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Unwrapping the Forrest Gump Budget

A mixed box of handmade bonbons, soft centres and empty chocolate wrappers

This evening, Federal Treasurer Scott Morrison released a suite of measures designed to drive economic and job growth, target tax avoidance by large multinationals and increase access to superannuation benefits for some Australians whilst limiting access for others.

Although the early leaking of Federal Budget measures has become an annual custom, Budget 2016/17 is best described as the Forrest Gump Budget – "just like a box of chocolates, you never know what you are going to get." And when the box was unwrapped, the Federal Government definitely did not disappoint.

From a tax perspective, the announcements concerning the changes to lifetime caps to non-concessional superannuation contributions, pension transfer balance caps, the change in the small business entity thresholds and the extent of the company tax rate cuts were certainly not anticipated by the pundits.

Australian resident companies, especially those in the $2m – $10m turnover range, have been able to pick all the "soft centred" chocolates, with these companies getting access to tax concessions relating to outright deductions for low cost assets, and simplified measures for depreciation, trading stock, GST and FBT. The proposed reduction in the company tax rate to 27.5% from 1 July 2017 for companies with less than $10m turnover and eventually 25% in the 2027 financial year for all companies, will have an impact on dividend yields and tax payments for shareholders in both private and public companies.

Large multinational organisations have certainly been given the "carob chocolates" in this Budget. As we have seen in recent years, they are an easy revenue target politically for Federal Governments, with different initiatives targeting multinationals to pay their "fair share" of Australian tax. The Organisation for Economic Co-operation and Development (OECD) has been working on a global action plan to limit tax avoidance of multinational groups, known as the Base Erosion and Profit Shifting (BEPS) action plan. Along with other developed economies, Australia has made a significant contribution towards development of the BEPS action plan.

With this Budget, Australia now joins the United Kingdom as being one of the only countries that have taken action outside of the BEPS action plan, by proposing domestic legislation to counter the tax leakage created by "new world" business models. The commercial reality of the proposed Diverted Profits Tax is that these entities will inevitably pass on any additional costs to their Australian customers. Read that as your monthly Netflix subscription going up in the near future!

The Federal Government realises that the mining investment boom is over and it is trying to stimulate the economy and jobs growth through investment in infrastructure and reducing tax on businesses, in turn encouraging businesses to reinvest in the economy. Business and individual tax cuts come at a cost and it seems that cigarette smokers and some superannuants have been left with the empty chocolate wrappers in this Budget.

With a Federal election on the horizon, the 2016/17 Budget was not expected to deliver major change, but has delivered more than many thought we would see. One wonders whether the Federal Government has hidden the best chocolates, the handmade bonbons, from view and will unveil them during the election campaign.

Con Paoliello
National Head of Tax Services

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CORPORATE BUSINESS

Cuts to Company Tax Rate

The company tax rate will be progressively reduced to 25% between the 2016/17 and 2026/27 income years.

A company tax rate of 27.5% will apply to companies with an annual aggregated turnover of less than $10 million for the 2016/17 year, increasing to an aggregated turnover of $1 billion by 2022/23. The tax rate will be further reduced progressively for all companies from the 2024/25 income year. A summary of the corporate tax rates can be found on the RSM Australia website at rsm.com.au

Franking credits will be eligible for distribution in line with the underlying tax rate paid by the company. We would expect that franking account balances will be adjusted upwards as company tax rates fall.

In addition, administrative penalties will be imposed on 'significant global entities' (companies with global revenue of $1 billion or more) will be increased from 1 July 2017.

Penalties relating to the lodgement of documents with the Commissioner will increase 100-fold, raising the maximum penalty from $4,500 to $450,000. Penalties relating to the making of statements to the ATO will be doubled.

CASE STUDY

ABC Pty Ltd has $100 million turnover each year, and earns a consistent $10 million profit before tax. The table below highlights the impact of the reduced tax rate on the tax paid and profit after tax of ABC Pty Ltd.

ABC Pty Ltd will therefore be unable to frank distributions at greater than its corporate tax rate (i.e. 30% for the first 2 years, 27.5% for 2019/20 to 2023/24, 27% for 2024/25, 26% for 2025/26, and 25% for 2026/27).

Income Year	Profit Before Tax	Tax Rate	Tax Paid	Profit After Tax	Maximum Franking Credit Rate
2017/18	$10 million	30%	$3 million	$7 million	30%
2018/19	$10 million	30%	$3 million	$7 million	30%
2019/20	$10 million	27.5%	$2.75 million	$7.25 million	27.5%
2020/21	$10 million	27.5%	$2.75 million	$7.25 million	27.5%
2021/22	$10 million	27.5%	$2.75 million	$7.25 million	27.5%
2022/23	$10 million	27.5%	$2.75 million	$7.25 million	27.5%
2023/24	$10 million	27.5%	$2.75 million	$7.25 million	27.5%
2024/25	$10 million	27%	$2.7 million	$7.3 million	27%
2025/26	$10 million	26%	$2.6 million	$7.4 million	26%
2026/27	$10 million	25%	$2.5 million	$7.5 million	25%

Tax Consolidation Integrity Measures

Three integrity measures will be introduced that relate to how the joining entity liabilities are measured in determining the Allocable Cost Amount (ACA) for tax consolidation purposes. Where an entity with a securitised asset (for example a mortgage securitisation investment) joins or exits a tax consolidated group, a mismatch can occur in the calculations because the securitised asset and the corresponding liability are not recognised in the same way. If a securitised asset won't be recognised for tax purposes, any liabilities arising from the securitisation arrangement will be disregarded for tax consolidation purposes.

The 2016/17 Budget Papers don't provide any detail about what Deferred Tax Liability (DTL) adjustments will be removed from the joining and exit calculations as a consequence of this announcement. It is likely, that the "iteration" calculations will be removed so that the value of a joining entity's equity will reflect its DTL rather than the value of the DTL that will be reflected in the group accounts.

The government issued an Exposure Draft that had proposed to introduce a new measure requiring a consolidated group to bring assessable income to account over a period of time if it acquired a joining entity with deductible liabilities from 14 May 2013. The 2016/17 Budget announcement will modify this proposed rule to exclude deductible liabilities from a joining entity's ACA from 1 July 2016.

CASE STUDY

A tax consolidated group (TCG) acquired an entity (JE) for $1,000. At the joining time the balance sheet of JE comprises plant with a book (and adjustable) value of $2,000 and deductible accruals (liability) for $1,000. Under the proposed measures TCG would have been required to recognise $1,000 as assessable income over a 12 month period from the joining time. Following the 2016/17 Budget announcement, TCG would not need to bring any amount into its assessable income relating to the deductible accruals of JE. If JE is acquired from 1 July 2016, the deductible accruals would not be recognised in the ACA of JE.

TOFA rules to be simplified

The current TOFA rules were primarily designed for the largest taxpayers however in practice also apply to a significant group of smaller taxpayers who have not enjoyed the envisaged compliance cost savings and simplification benefits.

This measure will reduce the scope of these provisions, decrease compliance costs and increase certainty through the redesign of the TOFA Framework. The main components of this measure include:

- A closer alignment between tax and accounting in the TOFA rules
- Simplified accruals and realisation rules
- A new tax hedging regime which is easier to access, encompasses more types of risk management arrangements and removes the direct link to financial accounting
- Simplified rules for the taxation of gains and losses on foreign currency

In addition, the Government will incorporate the policy reflected in a number of measures which have previously been announced but are yet to be legislated, including:

- Amendments to TOFA tax hedging rules; first announced in the 2011/12 Budget
- Technical and compliance cost saving amendments to TOFA foreign currency regulations; first announced in the Mid-Year Economic and Fiscal Outlook 2004-05
- Extending the range of entities that can use a functional currency, first announced in the 2011/12 Budget

These rules will apply to income years commencing on or after 1 January 2018.

National Innovation and Science Agenda

The 2016/17 Budget restates a number of measures and tax incentives applicable to investors in early-stage innovation companies and ESVCLPs that are incorporated within the raft of proposed amendments in the Tax Laws Amendment (Tax Incentives for Innovation) Bill 2016. This bill is currently before the Federal Parliament.

Measures to promote investment in early-stage innovation companies:

- A 20% non-refundable but carry-forward tax offset for investment in 'eligible' early-stage innovation companies
- Increasing accessibility to the CGT exemption, by reducing the minimum holding period from three years to 12 months
- Including a time limit on incorporation and criteria for determining whether a company is an 'innovation company' in the definition of eligible startups
- Requiring that investors and innovation companies are not affiliates
- Limiting the annual investment amount for non-sophisticated investors to $50,000 or less to receive a tax offset

Measures to promote investment in ESVCLPs:

- A 10% tax offset for investments in ESVCLPs
- Adding 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
- Relaxing the requirements for very small entities to provide an auditors' statement of assets
- Extending the increase in fund size to $200 million for new ESVCLPs to existing ESVCLPs
- Ensuring that the venture capital tax concessions are available for FinTech, banking and insurance activities

CASE STUDY

ABC Pty Ltd was incorporated on 1 July 2018 and conducts an 'eligible business'. It is not listed on a stock exchange, and for the year ended 30 June 2019 had income of $150,000 and expenses of $500,000. John, an early-stage investor in ABC Pty Ltd, subscribed for shares at a cost of $20,000. John is entitled to claim a tax offset for $4,000. John sells his ABC shares in 2021 for $50,000. As he has held the shares for longer than 12 months the capital gain will be exempt from CGT.

INTERNATIONAL

The Government has announced it will strengthen the anti-avoidance measures for multinationals recently legislated and previously announced in the 2015/16 Federal Budget by introducing the following additional measures:

- A 40% diverted profits tax (DPT), dubbed a "Google tax" when it was introduced in the UK in 2015
- Implementation of the OECD hybrid mismatch arrangement rules
- Strengthening of Australia's transfer pricing rules to align with the latest international arrangements
- A new Tax Avoidance Taskforce that will strengthen the ATO's audit and compliance activities targeting corporates and high wealth individuals
- Increasing administrative penalties for significant global entities

However, despite speculation before the Budget, the Government did not announce any changes to Australia's thin capitalisation rules. The "safe harbour" ratio remains 1.5:1 (on a debt:equity basis) and 60% / 40% (on a debt to total assets basis).

Diverted profits tax

The Government has announced it will introduce a diverted profits tax (DPT) of 40% on the profits of multinational corporations that are "artificially" diverted from Australia. The DPT will apply to income years commencing on or after 1 July 2017.

The DPT will target companies that shift profits offshore through arrangements involving related parties:

- That result in an amount of tax being paid overseas that is less than 80% of the amount of tax that would otherwise have been paid in Australia
- Where it is reasonable to conclude that the arrangement is designed to secure a tax reduction
- That do not have sufficient economic substance

Following the introduction of the UK's DPT (effective for accounting periods beginning on or after 1 April 2015), Australia introduced the Multinational Anti-Avoidance Law (MAAL) which broadly replicated the first limb of the UK's DPT. The MAAL is designed to counter the erosion of the Australian tax base by multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia.

In this regard, the ATO warned last week that companies were already gaming the system to avoid the MAAL and on 26 April 2016, the ATO issued Taxpayer Alert TA 2016/2 which set out their concerns in regard to certain taxpayer interim arrangements in response to the enacted MAAL.

The DPT will be based on the second limb of the UK's DPT and will help ensure that large multinational corporations pay an appropriate amount of tax on profits made in Australia.

In the Budget, the Government released a paper for consultation about implementing a DPT. The purpose of the paper is to outline how the DPT would apply in the Australian context. Comments are due by 17 June 2016.

Example:
Operation of the effective tax mismatch requirement

Company A has a $100 reduction to its Australian tax liability as a result of a deductible payment, but due to the lower tax rate in Company B's jurisdiction, Company B only has a $60 increase in its tax liability from the corresponding receipt.

As the tax liability for Company B in its home jurisdiction is less than $80, the DPT rules will prima facie apply.

To help provide certainty for lower risk entities, companies with Australian revenue of less than $25 million will be exempt from the DPT, unless they are artificially booking their revenue offshore. This threshold is similar to the thresholds applying for small taxpayers applying simplified transfer pricing record-keeping requirements and the threshold exempting small proprietary companies from certain financial reporting obligations under Corporations Act 2001.

It is anticipated the focus of the DPT provisions will be on those multinational groups who flow profits through low-tax jurisdictions such as Singapore and Ireland.

Unlike income tax, the DPT will not be a self-assessed tax – a DPT liability will only arise when the ATO issues a DPT assessment. The ATO will notify taxpayers if it considers that they may be subject to the DPT.

Multinational groups operating in Australia will need to consider the application of the DPT provisions to their Australian operations. Undoubtedly Australian Treasury officials will consult with their UK counterparts (and the ATO with the HRMC) in the design of Australia's version of the DPT.

Implementing the OECD hybrid mismatch arrangement rules

The most simple example of a hybrid mismatch is where an entity resident of country A makes a payment to an entity resident of country B. Country A might treat the payment as interest, and hence deductible. Country B might treat the payment as a dividend and tax exempt. The result being double non-taxation.

Neutralising hybrid mismatches was Action 2 of the OECD's wider, 15 point Base Erosion and Profit Shifting (BEPS) Action Plan. In terms of the example above, neutralising the hybrid mismatch would involve Country A denying a deduction for the interest payment.

The Government has announced it will implement the OECD rules to eliminate hybrid mismatch arrangements, taking into account the recommendations made by the Board of Taxation in its report on the *Australian implementation of the OECD hybrid mismatch rules* (pursuant to a request of the then Treasurer as part of the 2015/16 Federal Budget). The Government has asked the Board of Taxation to undertake further work on how best to implement these rules in relation to regulatory capital as part of this measure.

This measure is aimed at multinational corporations that exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions. This measure targets instances where tax is either deferred or not paid at all. It will apply broadly to related parties, members of a control group and structured arrangements.

This measure will apply from the later of 1 January 2018 or 6 months following the date of Royal Assent of the enabling legislation.

Again, in designing the legislation, Australia will no doubt consult with the UK who announced measures to address hybrid mismatches in their 2016 Budget.

Strengthening transfer pricing rules

The Government has announced it will be amending Australia's transfer pricing law to give effect to the 2015 OECD's transfer pricing recommendations. The strengthening of transfer pricing rules is covered by Actions 8 to 10 of the OECD's BEPS Action Plan.

The amendment will apply from 1 July 2016.

Australia's transfer pricing legislation currently specifies that it is to be interpreted so as to best achieve consistency with the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations as last updated in 2010. On 5 October 2015, the OECD released the report Aligning Transfer Pricing Outcomes with Value Creation to update the Guidelines.

The changes to the 2010 OECD Guidelines enhance guidance on intellectual property and hard-to-value-intangibles, and ensure that transfer pricing analysis reflects the economic substance of the transaction. Applying these changes to Australia's transfer pricing rules will keep them in line with international best practice so that profits made in Australia are properly taxed in Australia.

Compliance with Australia's transfer pricing rules is expensive and time consuming. The ATO has however developed some simplified transfer pricing record keeping options so that certain eligible businesses can opt to minimise some of their record-keeping and compliance costs. Australian SMEs subject to the transfer pricing rules should review their eligibility for one or more of these options.

Tax Avoidance Taskforce

The Government has announced it will provide $678.9 million to the ATO over the forward estimates period to establish a new Tax Avoidance Taskforce. This will enable the ATO to undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals.

The Taskforce will also directly target compliance cases against those exposed by the Panama Papers.

The Taskforce will have a critical role in delivering on the OECD recommendations in relation to all 15 BEPS Action items published in October 2015.

Increasing administrative penalties for significant global entities

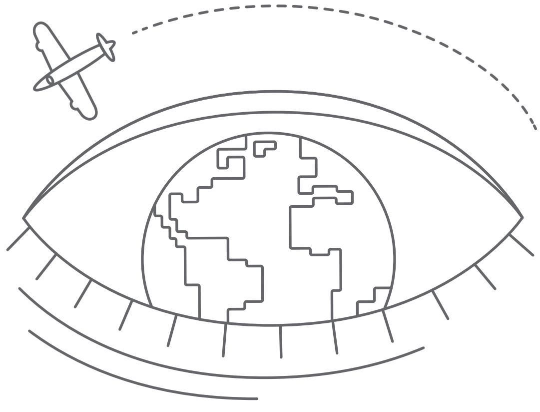
The Government has announced it will increase administrative penalties imposed on companies with global revenue of $1 billion or more who fail to adhere to tax disclosure obligations.

Penalties relating to the lodgement of tax documents to the ATO will be increased by a factor of 100. This will raise the maximum penalty from $4,500 to $450,000, which will help to ensure that multinational companies do not opt out of their reporting obligations.

Penalties relating to making false and misleading statements to the ATO will be doubled, to increase the penalties imposed on multinational companies that are being reckless or careless in their tax affairs.

In this regard, country-by-country reporting (CbCR) obligations now in force require these companies to lodge the following 3 reports:

- The master file (global group overview)
- The local country file (Australian operations only)
- The Country-by-Country Report (global summary of key metrics)



GST on low value imports

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

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, using a vendor registration model.

This follows the in-principle agreement made on 21 August 2015 by the Council on Federal Financial Relations Tax Reform Workshop.

CASE STUDY

An Australian consumer purchases clothes on-line from an overseas supplier for $100 on 25 June 2016 and no GST is charged on these goods as they enter Australia.

The same transaction occurs on 1 July 2017. Assuming the overseas supplier's Australian turnover is over $75,000, they will be required to register for, collect and remit GST for low value goods supplied to consumers in Australia. The cost of these clothes to the Australian consumer will be $110.

SMALL-TO-MEDIUM BUSINESS

- Increase in small business entity turnover threshold from $2 million to $10 million
- Increase the unincorporated small business tax discount
- Amendment to Division 7A to allow self-correction for inadvertent breaches

The Government has acknowledged that small businesses are a key component of our economy and are proposing to increase the small business entity turnover threshold from its current $2 million threshold to $10 million. From 1 July 2016 all businesses with a turnover of less than $10 million will have access to the following concessions:

- Simplified depreciation rules such as pooling and an immediate deduction for assets costing less than $20,000 up until 30 June 2017
- Simplified trading stock rules whereby a year end stocktake is not required if the value of stock has changed by less than $5,000
- The option to make PAYG instalments using the ATO instalment amount rather than calculating themselves

- Option to account for GST on a cash basis rather than an accruals basis
- More generous Fringe Benefits Tax exemption for work related portable electronic devices (from 1 April 2017)
- Access to the 12 month prepayment rule concession
- Option to trial a simpler Business Activity Statement format which is proposed to reduce GST compliance costs

These changes should reduce the compliance and tax cost for small to medium taxpayers and stimulate spending over the next 12 months with the $20,000 immediate write-off for depreciating assets being available to more taxpayers.

One key point to note is that this threshold increase does NOT apply to the small business capital gains tax concessions. For capital gains tax concession purposes the turnover threshold will remain at $2 million and the maximum net asset value test will remain as $6 million.

In the 2015/16 Budget the tax discount for unincorporated small businesses eg, partnerships and sole-traders was introduced. The current tax discount of 5% will increase to 8% from 1 July 2016 and will incrementally increase to 16% over 10 years. The Government will also increase the turnover threshold for these taxpayers from $2 million to $8 million.

The Government has also announced targeted amendments to Division 7A which will assist closely held private groups. Detail on the exact changes has not been released however, the Budget paper states:

- A self-correction mechanism will be implemented for inadvertent breaches of the rules
- Appropriate safe-harbour rules will be introduced to provide certainty
- Simplified Division 7A loan arrangements will be introduced
- A number of technical amendments will be made to improve the operation of Division 7A and provide increased certainty to taxpayers

Any changes which aim to ease the burden of Division 7A are welcome as the current Legislation is inflexible and does not easily allow for corrections for genuine mistakes made by taxpayers.

> Growing businesses which have a turnover that has exceeded the $2 million threshold will welcome the proposed increase in the turnover threshold. This will open up to them a raft of concessions which should ease their compliance burden and tax cost.

The general business economy will also welcome this change as they are likely to find over the next 12 months more businesses are willing to invest in capital assets due to being able to claim an outright tax deduction for assets costing less than $20,000.

Be prepared to hear more year end tax planning ads on your radio from electrical retailers!

CASE STUDY

Mark and Adam currently own a company, MA Bakeries Pty Ltd, through which they operate two bakeries in Western Australia. During the 2016-17 year the company has an aggregated turnover of $2,500,000 and taxable income of $190,000.

Mark and Adam purchased 2 new baking ovens costing $18,600 each (exclusive of GST) on 4 July 2016 in order to expand the baking capacity of the bakeries and to increase the sales to nearby restaurants and hotels.

Under the current law, the company will not be classified as a small business. Adam and Mark are required to depreciate the ovens using an effective life of 20 years. By using the diminishing value method of depreciation, the company can claim a tax deduction for the ovens of $3,688. This deduction will reduce the company's 2016-17 taxable income to $186,312, giving rise to a tax liability of $55,894 based on a company tax rate of 30%.

Under the new law, the company would be classified as a small business and would be entitled to the new small business tax rate of 27.5% from 1 July 2016.

Due to the ovens costing less than $20,000 each, the company will be entitled to an immediate tax deduction of $37,200 in the 2016-17 year. This will reduce the company's taxable income to $152,800, resulting in a tax liability of $42,020, with a company tax rate of 27.5%.

This will result in the company receiving a cash flow benefit of $13,874.

It is important to note that the changes to the small business turnover threshold are for income tax purposes only and does not impact the capital gains tax concessions, which remain at their current level of $2 million. Further, the immediate tax deduction for assets costing less than $20,000 is only until 30 June 2017.

SUPERANNUATION

The Government took a hard, and potentially unpopular line on superannuation tax concessions in the 2016/17 Budget, with changes including:

- The introduction of a $1.6 million pension cap
- Reduction in the concessional contribution cap PLUS more income earners captured under the 'higher income earners contribution tax'
- The introduction of a lifetime non-concessional contribution cap
- Removal of tax concessions for transition to retirement pensions

$1.6 million Transfer Balance Cap

In a move that has been long predicted by many, a new lifetime pension commencement cap has been introduced. From 1 July 2017, an individual may not commence a pension in superannuation with a balance of more than $1.6 million. In addition, for those with existing balances exceeding $1.6 million, the excess amount will need to be commuted back to accumulation, where the earnings will attract 15% tax. For those with multiple pensions, it is unclear how it will be decided which pension is converted back to accumulation, potentially undoing years of tax and retirement planning.

Contribution Changes

The 2016/17 Budget sees a return to a lower concessional contribution limit of $25,000 per member, regardless of age, effective from 1 July 2017. While the announcements also removed the draconian 10% rule and work test requirements to open up contributions to a wider group of people, it is the lowest contribution limit since the unpopular announcements in 2012-2013. In addition, for those individuals whose income (including superannuation) exceeds $250,000 an additional 15% tax will be payable on concessional contributions.

One minor positive to come from the changes is for those with superannuation balances of $500,000 or less. These members will be able to 'catch up' unused concessional contributions for a period of up to 5 years.

Lifetime Non-Concessional Cap

Possibly the least positive announcement to come from the Budget is the creation of a lifetime limit on non-concessional contributions. Commencing from 3 May 2016 and counting contributions back to 1 July 2007, a member is limited to a maximum of $500,000 of after tax contributions in their lifetime. Based on statistics that suggest only a very small percentage of individuals contribute amounts in excess of this, the Government believes this will prohibit high wealth individuals from investing large balances in a low tax environment.

This announcement will also limit the ability of individuals to employ the popular 'withdrawal and re-contribution' strategy to minimise the implication of tax on the death benefits of a member.

Transition to Retirement Income Stream & Tax

From 1 July 2017, the tax exempt status of income supporting a Transition to Retirement Income Stream (TRIS) will be removed, resulting in tax of 15% being levied on income in these funds. This is an attempt to remove the tax based strategies behind commencing a TRIS, and return it instead to a measure to help people genuinely moving toward retirement. The changes will also remove a loophole allowing members to elect to have their pension benefits taxed as a lump sum, potentially saving tax on withdrawals.

Low Income Benefits

A new Low Income Superannuation Tax Offset will be implemented to continue the proposed measures to provide greater equality in the superannuation tax system

Anticipating challenges,
identifying opportunities

for lower income earners. Any individual who has income of less than $37,000 will be entitled to a tax offset to their superannuation fund of up to $500, meaning that most low income earners will not pay any superannuation contributions tax.

The Budget also makes available increased access to the Spouse Offset, for individuals making a superannuation contribution for their spouse.

Anti-Detriment

A somewhat obscure but potentially valuable piece of legislation, the ability to make an anti-detriment payment will be outlawed by 1 July 2017. Previously, these rules effectively refunded the 15% contributions tax paid by a member over their lifetime back into their estate. Long misunderstood and constantly considered illogical, this removal was always on the cards.

The winners

- Low Income Earners
- Anyone with a superannuation balance of less than $500,000
- Anyone previously limited in making contributions by the 10% rule or the work test

The losers

- Anyone with a pension balance exceeding $1.6 million
- Anyone wishing to make a concessional contribution exceeding $25,000
- Anyone wishing to make non-concessional contributions exceeding $500,000 in their lifetime
- Anyone drawing a transition to retirement income stream post 1 July 2017

CASE STUDIES

Case Study 1:
Pamela, 78, has $2.5 million in superannuation – partially from her own benefits, and partially as a reversionary pension from her husband. From 1 July 2017, Pamela will need to convert $900,000 of her balance back to accumulation.

Case Study 2:
Cassandra, 67, is currently working part time and earning $32,000 a year. She has a superannuation balance of $385,000. Cassandra's employer makes a $3,040 contribution to her superannuation fund. Based on the changes, Cassandra can make an additional personal concessional contribution of $21,960 without having to worry about the 10% rule.

If the contributions made to Cassandra's fund this year only totalled $14,000, the unused cap of $11,000 would be able to be carried forward to next year, meaning total contributions of $36,000 could be made next year.

Case Study 3:
Michael is 57, and received an inheritance in 2008 from his mother of $400,000. He chose to contribute this to his superannuation fund. In 2018, Michael sells an investment property and after paying capital gains tax has $350,000 in after tax income. Because he used $400,000 in 2008, he is only able to contribute an additional $100,000 of his proceeds to superannuation.

INDIVIDUALS

> There are very few Budget measures impacting on personal income taxes for individual taxpayers and families. The key change for individuals is an increase to the threshold at which the 37% marginal tax rate for individuals commences.

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

The pause in the indexation of the income thresholds for the Medicare levy surcharge and the private health insurance rebate will also continue for another three years.

The 2% Budget deficit levy announced in the 2015/16 Budget will cease at the end of the 2016-17 financial year.

The Government has proposed to increase the taxable income at which the 37% tax rate applies from $80,000 to $87,000, with effect from 1 July 2016.

Under current tax rates (and excluding the 2% Medicare levy), taxable income within the $37,000 to $80,000 threshold is taxed at 32.5% and taxable income within the $80,000 to $180,000 threshold is taxed at 37%. Under the proposed changes, the $80,000 threshold will increase to $87,000 meaning taxable income within the $37,000 to $87,000 threshold will be taxed at 32.5% and taxable income within the $87,000 to $180,000 threshold will be taxed at 37%. The measures will apply to both Australian resident taxpayers and non-resident taxpayers.

The Government claims the measure will prevent approximately 500,000 taxpayers from being subject to the 37% tax rate for the next three years.

A summary of the tax rates and thresholds can be found on the RSM Australia website at rsm.com.au

The low-income threshold for the Medicare levy and surcharge will increase in line with movements in the Consumer Price Index so that low income earners will generally continue to be exempt from paying the Medicare levy.

The pause in the indexation of the Medicare levy surcharge and the private health insurance rebate tiered income thresholds will continue for another three years. This will act as a form of "bracket creep" for taxpayers on medium to high incomes, resulting in taxpayers with private hospital cover paying more for their health insurance coverage, and those without private hospital cover paying additional Medicare Levy Surcharge.

The 2% Budget deficit levy announced in the 2014/15 Budget and originally legislated to apply for 3 years from 1 July 2014 will cease at the end of the 2016-17 year. This will result in a tax saving for taxpayers with taxable incomes of $180,000 or more.

The winners

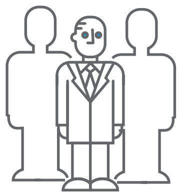
Approximately 500,000 middle income taxpayers will benefit from the proposed changes. These taxpayers would have moved into the higher 37% marginal tax rate from the 2016/17 year, whereas now, they should avoid the higher marginal tax bracket for another three years.

High income earners will benefit marginally from the change in the income tax brackets with approximately $7,000 of taxable income earned above $80,000 being taxed at 32.5% as opposed to 37%.

The losers

Unfortunately low income earners will see no benefit from the proposed budget changes other than an increase in the low-income threshold for the Medicare Levy and surcharge to account for movements in the consumer price index.

Middle and high income taxpayers who win with the cut in marginal tax rates may lose some of their tax cut through increases in Medicare Levy Surcharge or private health insurance premiums.



CASE STUDIES

Case Study 1:
Matt is a middle income earner, his taxable income in the 2015/16 year was $80,000 and he is expecting this to increase to $85,000 in the 2016/17 year.

The tax payable on Matt's taxable income under the current thresholds (not including the Medicare levy or surcharge) would be $19,397. Under the proposed changes, the tax payable on Matt's taxable income would be reduced to $19,172, giving him an overall saving of $225.

Case Study 2:
Rachael's taxable income in the 2015/16 year was $88,000 and she is expecting this to increase to $91,000 in the 2016/17 year. Rachael is young and single, and has not taken out a private health insurance policy with hospital cover.

The tax payable on Rachael's taxable income under the current thresholds (including the Medicare levy) would be $23,437. Under the proposed changes, Rachael will benefit from the increase in the income tax threshold, but will become liable to pay the Medicare Levy Surcharge, resulting in her total tax payable increasing to $24,032, leaving her out of pocket by $595.

INNOVATION

> The support for innovation in the 2016/17 Budget can be simply summarised as disappointing tinged with relief in a lack of cutbacks. There are only very minor announcements for innovation support through specific focuses, such as $200,000 for FinTech and $2.4 million for Landing Pads in Singapore and Berlin.

Given the Government's continued hype of its support for the Innovation Economy it looks like they are more interested in TV ads than actual programs to support innovation.

The Budget makes a big deal of referring to their National Innovation Science Agenda (NISA) of $1.1 billion. So far this Agenda has been confusing and disjointed in its release. There are some good programs and ideas within it that are being developed and released but it is hard to find how they can justify it as a $1.1billion package.

A potential unintended benefit for Innovators from the Budget is the impact corporate tax rate cuts have on increasing the benefit of the R&D Tax Incentive. If the R&D Tax Incentive rate is not cut back to align with reductions to the corporate tax rate, the gap between the R&D rate and the corporate tax rate widens and thus provides an increase in the actual net benefit of the R&D Tax claim. This is equivalent to leaving the corporate tax rate the same while increasing the R&D Tax Incentive rate. However, while R&D Tax Incentive rates have not been announced to change in line with the corporate tax rate we assume that this will be addressed during legislation preparation.

The positive outcome of the Budget for innovation is the lack of cuts, particularly to the flagship Innovation support mechanism, the R&D Tax Incentive. A review is currently underway with the R&D Tax Incentive and we are holding our breath to see what the outcome will be. Our hope is that the outcome of the Review is that the cost of the R&D Tax Incentive is finally corrected after many years of inaccurate and aggressive modelling. Currently we estimate that the program's budgeted cost is overstated by $1billion per year. Further, if the budget calculations of the R&D Tax Incentive were based on the recommended Revenue Gain method, the program is potentially revenue neutral at least.

There is no reference or related commentary as to whether the Government intends to continue to pursue the previously proposed legislation for a 1.5% R&D Tax Incentive cut. As this was included in the last Budget, we expect that if the Government wants to keep this cut they will simply reintroduce legislation and do not need to announce it in this or future budgets. Therefore, due to this, plus the pending R&D Tax Incentive review outcomes, the Innovation industry is very concerned that the Government is withholding bad news for the time being.

Finally, Australian Innovation commercialisation results have been below international standards for many years. This supposedly is being addressed through NISA, however it lacks the tax changes that many believe are required to address this challenge in Australia. Tax levers are a simple and low cost mechanism to address this, through a premium R&D Tax Incentive for research collaboration and patent box style commercialisation incentives, Australia's results for Innovation commercialisation results would increase greatly.

The Government can use the savings from correctly modelling the R&D Tax Incentive to pay for much needed innovation support to improve Australia's international competitiveness.

A LOOK AT THE 2015/16 BUDGET

Which measures were enacted?

A number of announcements from the 2015/16 Budget remain unenacted, with many of these announced measures yet to be introduced into Parliament as bills. The link below lists the taxation measures that:

- Have been passed and have become law
- Have been introduced into Parliament
- Are yet to be introduced into Parliament

Whilst the Coalition Government passed most of its major 2015/16 Budget announcements, its lack of success in implementation of other measures reflects the tough environment in which they have had to operate, including dealing with an often hostile Senate, and internal party frictions.

On the understanding that the Coalition will now request a double dissolution of Parliament, previously announced Budget measures that have been introduced into Parliament will lapse. The fate of these measures, along with those measures for which bills have not yet been drafted, remain uncertain. This will cause concern for measures that are intended to apply from the date of announcement, or for which the proposed start date has already passed, as business and tax advisers alike will remain in the dark as to whether the Government will in fact proceed with these measures at a later time.

With "legislation by announcement" being a feature of modern politics, having a backlog of unenacted taxation measures is a frustrating, but common occurrence. When elected in 2013, the Coalition Government inherited some 92 announced but unenacted measures, and should be commended for the prompt action taken in 2013 to clear this backlog.

Advisers and business owners are hoping that whichever party is elected to Government in July 2016, these prior year measures will be dealt with as swiftly as the Coalition Government did with the measures they inherited in 2013.

Progress of selected measures announced in Budget 2015-16

Measure	Summary	Start date	Status
Changes to work-related car expense deductions	"12% of original value method" and "one-third of actual expenses method" removed. Rate for "cents per kilometre method" set at 66 cents/km for all motor vehicles. Future year rates to be set by the Commissioner. No changes to "logbook method".	1 July 2015	Enacted
Changes to tax residency rules for temporary working holiday makers	"Backpacker tax" aimed at treating most people who are temporarily in Australia for a working holiday as non-residents for tax purposes. This removes access to the tax-free threshold and low marginal rates of tax for these taxpayer.	1 July 2016	Not introduced into Parliament – subject to ongoing consultation
Medicare levy low-income thresholds (2015)	Annual threshold increases for application of Medicare Levy	1 July 2014	Enacted
Zone tax offset changes	Amendments to exclude "fly-in fly-out" and "drive-in drive-out" workers from accessing the zone rebate where their normal residence is not within a "zone".	1 July 2015	Enacted
Child care system reforms	A new Child Care Subsidy will be introduced from 1 July 2017 to replace the existing Child Care Benefit and Child Care Rebate. Measures are designed to support families where both parents work.	1 July 2017	Introduced, but bill lapsed
Accessing parental leave pay from both employer and government	Removal of ability for individuals to receive benefits from both the government Parental Leave Pay scheme, and employer provided parental leave schemes.	1 July 2016	Introduced, but bill lapsed
Multinational anti-avoidance provisions	Multinational entities with global revenue of $1b or more subject to stricter rules on using artificial arrangements to avoid tax in Australia	1 January 2016	Enacted

Measure	Summary	Start date	Status
Penalty rules for large multinational groups	Increase in maximum administrative penalties that can be imposed on large companies entering into tax avoidance and profit shifting schemes.	1 July 2015	Enacted
Transfer pricing documentation changes	The OECD's new transfer pricing documentation standards will be implemented from 1 January 2016 for companies with a global revenue of $1b.	1 January 2016	Enacted
Other multinational tax avoidance measures	Board of Taxation will consult on implementation of OECD draft plan to tackle problem of multinationals claiming a tax deduction in one country but not paying tax in another.	No date specified	Announced
Company tax rate cut	Reduction of tax rate from 30% to 28.5% for companies with an aggregated annual turnover of less than $2m.	1 July 2015	Enacted
Small business tax discount	Individual taxpayers with business income from an unincorporated business with less than $2m annual turnover entitled to tax discount of 5% capped at $1,000 per individual, each income year.	1 July 2015	Enacted
Instant asset write-off threshold	Instant asset write-off threshold will be increased from $1,000 to $20,000 for assets acquired and installed ready for use between 7.30 pm (AEST) 12 May 2015 and 30 June 2017.	12 May 2015 7.30PM	Enacted
Business establishment expenses	An immediate deduction will be available for professional expenses associated with starting a new business. Previously only eligible for five year write-off.	1 July 2015	Enacted
CGT relief for small business restructures	Small businesses with an aggregated annual turnover of less than $2m may obtain CGT relief where they change the legal structure of their business.	1 July 2015	Enacted
FBT exemption for portable electronic devices	Small businesses with an aggregated annual turnover of less than $2m may get an exemption where they provide their employees with more than one qualifying work-related portable electronic device per year.	1 April 2016	Enacted
FBT: meal and entertainment for not-for-profit employees	The Government has introduced a single grossed-up cap of $5,000 to salary packaged meal entertainment and entertainment facility leasing expenses provided to employees of FBT rebatable and exempt employers. The Government also announced that all such salary packaged entertainment provided from 1 April 2016 would also potentially be reportable and included in employee payment summaries. As such, FBT rebatable and exempt employers will be required to use the 'actual method' to work out the amount of salary packaged meal entertainment or entertainment facility leasing expenses subject to FBT (i.e. the 50:50 method cannot be used). Historically there has been no cap for these benefits.	1 April 2016	Enacted
GST on offshore supplies of services and intangibles	"Netflix tax" aimed at ensuring supplies of services and intangibles provided to Australian consumers by offshore providers will be subject to GST.	1 July 2017	Introduced, but bill lapsed
Accelerated depreciation for primary producers	An immediate deduction for capital expenditure on fencing and water facilities such as dams, tanks, bores, irrigation channels, pumps, water towers and windmills is available for primary producers. Capital expenditure on fodder storage assets used to store grain and other animal feed will be deductible over three years.	12 May 2015 – 7.30PM	Enacted
Employee share schemes (ESS) amendments	Technical amendments to ESS concessions for eligible start-up companies, including: ▪ Exclusion of eligible venture capital investments from turnover test and grouping rules for access to concessions ▪ Extending access to 50% CGT discount, by aggregating holding period for options that are converted into shares where shares subsequently sold ▪ Granting Commissioner discretion to disregard three year minimum holding period rule in certain circumstances	1 July 2015	Enacted

INDUSTRIES

AGRIBUSINESS

Whilst there are no specific incentives for Agribusiness, many of the proposed changes will impact this sector including:

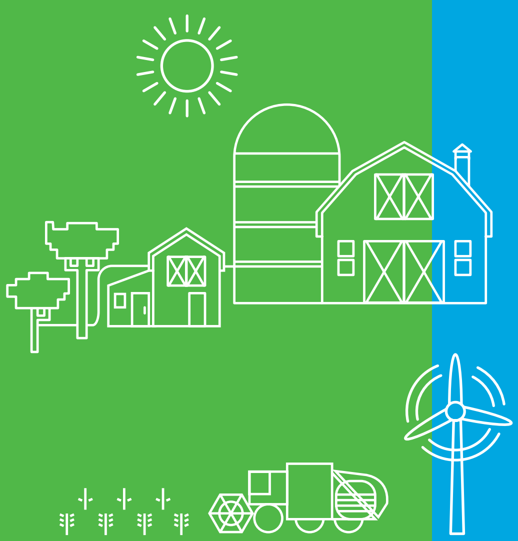
- The changes for eligibility for access to the Small Business concessions
- Reduction in the company tax rate for those carrying on business
- The stretching of the 32.5% tax rate band to $87,000
- Changes to Superannuation, which will throw many plans into disarray

The winners

- Those agribusinesses, incorporated or unincorporated that currently have a turnover in excess of $2m but less than $10m will be able to access lower tax rates or offsets as well the small business concessions, in particular the immediate deduction of depreciable assets costing less than $20,000
- Those earning currently between $80,000 and $87,000
- Companies carrying on business with the reduction in the company tax rate

The losers

- Superannuants and the confidence in the superannuation system
- Dividend recipients as the franking credit available will reduce
- Those with large or small superannuation account balances



CASE STUDY

Mike is a partner in a farming partnership in a marginal area. Historically the farm has fluctuating income years. In the good year the averaging provision will likely be of greater benefit with the lifting of the 32.5c tax band to $87,000.

He has been unable to make any concessional contributions to superannuation for the 2018, 2019, 2020 and 2021 years. In 2022 he has a good year and can use the carry forward unused concessional carry forward amounts of $100,000 (4 years) plus a current year amount of $25,000 allowing him to contribute $125,000 reducing his tax exposure. Currently he could only make a contribution of up to $35,000.

Wine Equalisation Tax

The eligibility for the wine equalisation tax (WET) rebate, which is currently worth up to $500,000 per claimant, will be tightened up, and the amount available to producers will be limited to $350,000 from 1 July 2017 and $290,000 from 1 July 2019. There will also be a crackdown on companies making multiple claims, and much stricter definitions as to what constitutes a winery or a producer. 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.

The move is predicted to benefit small producers further. Under current rules, any producer who has less than $1.7 million in wholesale sales either pays no WET, or receives a net payment from the rebate – so small producers benefit most, as a proportion of sales.

The original intention of the rebate when it was introduced in 2004 was to assist small wine producers in rural Australia and to boost regional tourism, and the changes in the Budget will aim to restore that intent.

> The move has been welcomed by the Winemakers Federation of Australia and Wine Grape Growers Australia, who have been lobbying hard to scale back the rebate to restore "integrity" into the sector.

The two bodies had lodged a joint submission claiming the WET rebate was holding up changes necessary within the industry, and allowing "uncommercial" grapes to be used for bulk wine and sold off cheaply. They also accused the bulk wine sector of exploiting the rebate system, and "impoverishing wine grape growers" and diminishing the ability of winemakers to add value to their brands.

PROPERTY & CONSTRUCTION

- National Infrastructure Plan – the Government reaffirmed its commitment to invest $50 billion in infrastructure in relation to various projects across the States and Territories
- Growth in dwelling investment expected to ease to only 1% by 2018
- Reduction in the company tax rate to 27.5% from 1 July 2016 for businesses with a turnover of less than $10 million
- The current 5% tax discount for sole traders to be increased to 8% from 1 July 2016 (although the cap of $1,000 still remains)
- Capital allowance, GST and reporting concessions available for small businesses extended to businesses with a turnover of less than $10 million
- A new Tax Avoidance Taskforce will be established to target large private groups and high wealth individuals

The construction industry is a significant driver of economic activity in Australia. It is Australia's third largest industry, behind only mining and finance. It compromises close to 350,000 businesses nationwide and is mainly comprised of businesses with less than 20 employees [Source: ABS: Counts of Australian Businesses, June 2015].

From an industry perspective, the Budget has provided some consistency in relation to infrastructure spending with the Government re-emphasising the $50 billion package of infrastructure spending announced in last year's Budget including committing to provide $2.9 billion for significant new investments in essential infrastructure across Australia. In particular, an additional $594 million will be committed to the Melbourne to Brisbane Inland Rail Project and $115 million for development planning for a Western Sydney Airport.

In other States, additional funding is provided for the Forrestfield-Airport Link and Perth Freight Link in Western Australia and in Victoria, funding for the Melbourne East West Link will be reallocated to other projects such as the upgrade of the Monash Freeway, the Murray Basin freight rail and regional roads.

Dwelling investment grew at a record 7.9% in 2014-15 on the back of low interest rates but is expected to ease to only 2% by 2017 and 1% by 2018 as the elevated levels of work under construction are completed.

While the industry will breathe a sigh of relief that there were no surprises in the 206/17 Budget (e.g., no changes will be made to negative gearing), the expected ease in the growth of dwelling investment to only 1% by 2018 will dampen any excitement concerning the extension of concessions for small business (e.g., the $20,000 immediate write-off for depreciating assets) to businesses with a turnover of less than $10 million.

Some of the 2016/17 Budget announcements relevant to the industry include:

- There will be no changes made to negative gearing as expected.
- A new Tax Avoidance Taskforce will be established to target large private groups and high wealth individuals in high risk areas (no doubt the building and construction industry being one of those areas). Accordingly, large private groups in the industry can expect to be under greater ATO scrutiny

- The Government will increase the tax discount for unincorporated small businesses (e.g., sole traders) with an annual turnover of less than $5 million) incrementally over 10 years from 5% to 16%. The tax discount will increase to 8% on 1 July 2016. However, the current cap of $1,000 per individual for each income year will be retained
- The company tax rate for businesses with an annual aggregated turnover of less than $10 million will be reduced to 27.5% from the 2016-17 income year
- From 1 July 2016, all businesses with an annual aggregated turnover of less than $10 million will have access to small business concessions such as the immediate tax deductibility for asset purchases costing less than $20,000 until 30 June 2017 (then $1,000 thereafter) and the option to account for GST on a cash basis

CASE STUDIES

Case Study 1
Bob is a sole trader that operates as an independent contractor in the building and construction industry. Bob's taxable income from his construction business amounts to $150,000. Bob earns no other income. Under the current rules, the tax discount is 5%. From 1 July 2016, this increases to 8% with a maximum discount of $1,000.

Bob will pay approximately $45,132 (including the Medicare levy) in tax under the new rules which provides a saving of $1,315. The tax discount for sole traders amounts to $1,000 of this saving.

Case Study 2
Bill operates a profitable plumbing business via his company Drain Away Pty Ltd. During the 2016-17 year the company has an aggregated turnover of $2,500,000 and taxable income of $190,000. On 4 July 2016 Drain Away Pty Ltd acquires 2 new mini excavators for $18,600 each excluding GST.

Under the current law, the company will not be classified as a small business. Drain Away Pty Ltd is required to depreciate the excavators using an effective life of 20 years. By using the diminishing value method of depreciation, the company can claim a tax deduction for the excavators of $3,688. This deduction will reduce the company's 2016-17 taxable income to $186,312, giving rise to a tax liability of $55,894 based on a company tax rate of 30%.

Under the new law, the company would be classified as a small business and would be entitled to the new small business tax rate of 27.5% from 1 July 2016.

Due to the excavators costing less than $20,000 each, the company will be entitled to an immediate tax deduction of $37,200 in the 2016-17 year. This will reduce the company's taxable income to $152,800, resulting in a tax liability of $42,020, with a company tax rate of 27.5%. This will result in the company receiving a cash flow benefit of $13,874 in the 2017 financial year.

Budget 2016

WINNERS & LOSERS

Corporate
Company tax rate will be progressively reduced to 25% by 2026/27

Innovation
Some measures including 20% non-refundable but carry-forward tax offset for investment in 'eligible' early-stage innovation companies

Superannuation
Resident shareholders (e.g. retirees and superannuation funds) seeking franking offsets to shelter tax payable

Consumers
Consumers will have to pay GST when buying goods on-line from overseas suppliers that have an Australian turnover of $75,000 or more

Small business
Proposed reduction in company tax rate to 27.5% for companies with less than $10m turnover

International
New Diverted Profits Tax will be introduced – 40% penalty rate on multinational corporations that attempt to shift profits offshore

Individuals
There will be an increase to taxable income at which the 37% tax rate applies, from $80,000 to $87,000

Corporate
The reduction in Company tax rates should result in increased investment, higher real wage growth and possibly larger dividends for shareholders

Superannuation
- $1.6 million transfer balance cap – tax free retirement phase accounts
- 30% tax on concessional contributions for those earning over $250,000 per annum
- Lower $25,000 annual concessional contributions cap
- Introduction of a $500,000 lifetime non-concessional cap

Wine
The Wine Equalisation Tax rebate cap reduces from $500,000 to $350,000 from 1 July 2017 (and $290,000 from 1 July 2019) with increased funding for the promotion of Australian wine here and overseas

Small business
Businesses with $2m to $10m turnover gain access to:
- Instant asset write off
- Simplified depreciation
- Simplified GST

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