2018 FEDERAL BUDGET COMMENT

A pre-election Budget by the Coalition aimed at winning back some alienated voters and at differentiating Labor's policies.

The key elements of the Budget handed down on Tuesday night are:

- Ongoing failure of government on all sides to promote much needed major tax reform. We continue to tinker with and add complexity to an ancient system that is out of step with modern life and essentially out of control. The current system is closer to collapse than you might think.

- In the absence of tax reform, a marked focus on compliance to supposedly bolster revenue by clawing back leakage. Tax reform would remove current over-reliance on taxes based on net income and address leakage by focusing on taxes that are hard or impossible to avoid.

- A program of income tax cuts aimed at supporting ordinary people working hard to try and get ahead. It is hard to see this not flushing out a socialist agenda if opposed by Labor / Greens.

- Positive measures to enhance the flexibility and efficiency of Self-Managed Superfunds (SMSFs). This is to redress, in part, the horrible superannuation reforms that were in last year's budget, and to counter Labors blatant and blunt attack on SMSFs through proposed imputation changes. Given that Labor policy is so inaccurately targeted, either they have no idea what they are doing or are being directed by union run industry funds in order to restore their market share and power. Probably both!

- Not a lot by way of expenditure restraint or addressing government debt.

There is very little to take out of this budget in terms of immediate actions or tax planning opportunities. There are tax issues worth knowing about, though much remains to be clarified before 1 July 2019. The positive vibe of this budget will unfortunately be killed off by our self-absorbed and dysfunctional parliament. Some aspects will be abandoned or modified, other parts will add to the current backlog of pending legislation.

We will report back to you soon to cover 2018 financial year end issues.

PERSONAL TAX RATES AS ANNOUNCED

The proposed progression of tax rates is shown below with changes highlighted:

Resident Individual Tax rates and thresholds				
Rate	**2017-18**	**2018-19 to 2021-22**	**2022-23 and 2023-24**	**2024-25 onwards**
0%	$0 - $18,200	$0 - $18,200	$0 - $18,200	$0 - $18,200
19%	$18,201 - 37,000	$18,201 - 37,000	$18,201 - **41,000**	$18,201 - $41,000
32.5%	$37,001 - **87,000**	$37,001 - **90,000**	**$41,001 - 120,000**	$41,001 - **$200,000**
37%	**$87,001** - $180,000	**$90,001** - $180,000	**$120,001** - $180,000	N/A
45%	$180,001+	$180,001+	$180,001+	**$200,001+**

The Medicare Levy will stay at 2% subject to various low-income thresholds. The Government had previously proposed to increase the Medicare levy from 2% to 2.5% from 1 July 2019.

In addition to the existing Low-Income Tax Offset (LITO) there will be a Low and Middle Income Tax Offset (LAMITO) from 2018-19 to 2021-22

LITO – Current (2018 & 2019)		**LAMITO – Proposed (2019 to 2022)**	
$0 – 37,000	**Up to $445**	**$0 – 37,000**	**Up to $200**
$37,001 – 66,666	**$445 - 1.5% of excess over $37,000**	**$37,001 – 48,000**	**$200 + 3% of excess over $37,000**
$66,667+	**Nil**	**$48,001 – 90,000**	**$530**
		$90,001 – 125,333	**$530 - 1.5% of excess over $90,000**
		$125,334+	**Nil**

Comment:

- *Can't complain about a reduction in personal income tax no matter how small.*
- *Having two offsets where there could be one or none is very inefficient. Very costly for government and industry to implement and adjust systems.*
- *Aligning the top personal tax rate and the company tax rate would remove the need for most of the complexity in the tax system. This is a promising move to flatten the tax rates, but the top marginal rate stands out like a sore thumb and can only go away when the emphasis moves away from net income as a taxing base.*
- *Under the proposals the tax rate will eventually jump by 12.5% once the $200k threshold is reached. That is unworkable. A tax jump like that on a dollar earned over $200k is massive disincentive and will lead to all manner of costly tax planning attempts.*

COMPLIANCE CRACKDOWN IN LIEU OF TAX REFORM

ANNOUNCEMENT	*COMMENT*
The ATO will be provided with $130.8m from 1 July 2018 to increase compliance activities targeting individual taxpayers and their tax agents.	*It is hard to gauge the impact of this. For example, the ATO have recently announced a crackdown on 2018 Motor Vehicle Claims as an avenue to save on massive tax leakage. To some extent it has all been said before, though proceed with care.*
The Government will provide $318.5 million over 4 years from 1 July 2018 to implement additional strategies to combat the black economy. Revenue expectations linked with this are $3 billion over the next 4 years.	*The black / cash economy, especially small-scale transactions are notoriously hard to monitor. Some of the measures set out below will however definitely further reduce these activities.*
The Government will consult on and design a new regulatory framework for Australian Business Numbers (ABNs) in the 2018-19 income year.	*Monitoring legitimacy of ABNs has been lax from the outset. Its easy to get an ABN and it takes the two years of non-reporting before the ATO will take it away.*
No tax deduction for non-compliant PAYG and contractor payments. From 1 July 2019 employee and contractor payments that should have tax deducted but don't will be denied as a tax deduction.	*This is a piece of nastiness that all businesses need to watch out for. Depending on the detail, making an error in classifying a payee will be very costly. This would also appear to transfer the policing of this onto tax agents who will be legally obliged to not claim payments that do not follow tax withholding requirements.*
From 1 July 2019 the Reportable Payments System will be extended to the following industries: **1. Security providers and investigation services;** **2. Road freight transport;** **3. Computer system design and related services.** **The system is already set to extend to the cleaning and courier industries from 1 July 2018 and has applied to the building industry since 1 July 2012.**	*This rehash of the long forgotten Prescribed Payments System (PPS) is now on steroids. Businesses in these industries making payments to contractors in the industry must report the payments to the ATO by 28 August each year. This presumably allows the ATO to ensure the payments are returned as income by the contractor. This is an additional compliance burden for businesses.*
From 1 July 2019 there will be a limit of $10k on the amount that can be paid to a business for goods and services in cash. Transactions over this threshold must be made either electronically or by cheque.	*It is difficult to imagine how this is going to be implemented and how it will be policed. Potentially more work for businesses as unpaid tax collectors.*
The government will provide ATO $133.7m in extra funding to collect their debts properly. This is estimated to drag in an additional $1.2b in collections over 4 years.	*The ATO are notoriously bad at collecting their debts. If they would have otherwise let $1.2b slide, then that is proof.*
The Government has flagged a package of reforms intended to "deter and disrupt" phoenix activity. This will include extending the director penalty regime to GST, LCT and WET. There is no time frame set for these measures.	*Phoenix companies rack up debts to creditors, notably the ATO. The 'proprietors' of these companies strip out the assets then desert the company. We know the ATO must be well versed in these issues now, based on the recent alleged activities of the Cranston Family. No doubt the changes will add to the potential liabilities and risk of undertaking a directorship role.*

“CLARIFICATION” BY LEGISLATION

Treasury have announced legislation to curtail tax planning that in some instances would fail anyway under existing very widely drawn anti-avoidance rules:

TESTAMENTARY TRUSTS

Currently, income received by minors from testamentary trusts is taxed at normal adult rates rather than the higher tax rates that generally apply to minors. From 1 July 2019, the concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from <u>assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets</u>. This is to prevent injection of assets into testamentary trusts to magnify the tax benefits.

<u>Comment:</u>

- *Until there is legislation for this it will be difficult to know the impact.*
- *Typically, legislation for this type of measure oversteps the announcement. The result may restrict to some extent the way testamentary trusts can be operated. Based on the announcement though, the basic tax benefits of Testamentary Discretionary Trusts (TDTs) will remain intact.*

HIGH PROFILE INDIVIDUALS INCOME ALIENATION

Some appropriately famous people have been licensing the use of their fame or image to a related entity allowing income splitting or other improved tax outcomes. From 1 July 2019 all remuneration (including payments and non-cash benefits) provided for the commercial exploitation of a person's fame or image will be included in the assessable income of the individual.

<u>Comment:</u>

- *We can’t have these tall poppies using their fame to generate tax advantage, especially if politicians are so on the nose they can’t do it themselves!*

CIRCULAR TRUST DISTRIBUTIONS

The government is extending anti-avoidance provisions specifically to cover the situation where family trusts act as beneficiaries of each other in a round robin arrangement such that a distribution can ultimately be returned to the original trustee in a way that avoids any tax being paid on that amount.

<u>Comment:</u>

- *The ATO don’t already have the power to rule against a transaction with no economic effect as described? Be on the look out for legislative overreach here also.*

DEDUCTIONS FOR HOLDING VACANT LAND

From 1 July 2019 “the Government will deny deductions for expenses associated with holding vacant land”. Non-deductible costs will be eligible to form part of the CGT Cost Base.

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

“*This measure will not apply to expenses associated with holding land that are incurred after:*

- *a property has been constructed on the land, it has received approval to be occupied and is available for rent; or*
- *the land is being used by the owner to carry on a business, including a business of primary production.”*

“This measure will apply to land held for residential or commercial purposes. However, the ‘carrying on a business’ test will generally exclude land held for commercial development.”

Comment:

- *This has been quoted direct from the Budget papers because its absolute gobbledygook!*
- *The scope of this is very hard to determine. It seems to deny deductions for holding costs which would normally be deductible in the planning and construction phases of an investment property. If so that is a significant detrimental change.*

TOKEN SUPPORT FOR SELF–MANAGED SUPER

Kelly O’Dwyer is no friend of SMSFs after introducing Transfer Balance Capping and further contribution restrictions in the 2017 Budget, turning what was made simple back in 2007, into misery and complexity. Perhaps realising she has given a massive free kick to union controlled industry funds we now see some measures positive for SMSFs:

SMSF MEMBER LIMIT INCREASED FROM 4 TO 6 FROM 1 JULY 2019

This was announced to allow SMSFs greater flexibility to jointly manage family retirement savings. This will be implemented after consultation with the ATO. Currently each member needs to be a trustee or director of a trustee company.

Comment:

- *This will assist larger families pool their investments and or manage lumpier long-term assets such as commercial / business real property along with cash flow required for pensions and death benefits.*
- *The addition of family members needs to be thought through very carefully in terms of the impact on administration of the fund and for estate and succession planning. Unplanned changes in control of the fund, for example on the death of a member, can have unintended and disastrous consequences.*
- *Having extra members may enable the fund to avoid the denial of franking refunds as proposed by Labor.*

LIMITED WORK TEST EXEMPTION

The Government will introduce an exemption from the work test for voluntary superannuation contributions by individuals aged 65-74 with superannuation balances below $300,000 in the first year that they do not meet the work test requirements.

Comment:

- *The work test requires a minimum of 40 hours in any 30-Day period to qualify to contribute upon reaching age 65.*
- *This gives some extra flexibility to top up after ceasing work for some people.*
- *It applies to all superannuation funds not only Self-Managed*

SUPER GUARANTEE 9.5% OPT OUT FOR HIGH INCOME EARNERS

High income earners with multiple employers often are unable to avoid breaching their concessional contribution cap of $25k because of compulsory employer contributions. The Government will allow individuals whose income exceeds $263,157 and have multiple employers to nominate that their wages from certain employers are not subject to the superannuation guarantee (SG) from 1 July 2018.

Comment:

- *A cap breach triggers paperwork which has an administrative cost and inconvenience.*
- *This is a sensible option provided that the superannuation contributions forgone are equalised by adjustment to the salary package.*

SMSF AUDIT CYCLE EXTENDED TO 3 YEARS

The annual audit requirement for self-managed superannuation funds (SMSFs) will be extended to a 3-yearly cycle for funds with a history of good record-keeping and compliance.

Comment:

- *Hopefully this might reduce administration costs for SMSFs. It will certainly save some preparation time in non-audit years.*
- *It will be interesting to see the impact on the SMSF audit industry who currently do these audits for next to nothing. We suspect the cost of the 3-year audit will be 3 times the current cost because the responsibility and work of the auditor would not diminish much.*

BUSINESS AND ENTITY TAX MEASURES

SMALL BUSINESS $20K WRITE OFF EXTENDED AGAIN

The Government will extend the current instant asset write-off ($20,000 threshold) for Small Business Entities (SBEs) by 12 months to 30 June 2019. This applies to businesses with aggregated annual turnover less than $10 million. The threshold amount was due to return to $1,000 on 1 July 2018.

As a result of this announcement, SBEs will be able to immediately deduct purchases of eligible depreciating assets costing less than $20,000 that are acquired between 1 July 2018 and 30 June 2019 and first used or installed ready for use by 30 June 2019 for a taxable purpose. Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the general small business pool (the pool) and depreciated at 15% in the first income year and 30% each income year thereafter. The pool can also be immediately deducted if the balance is less than $20,000 over this period (including existing pools).

Comment:

- *This is the second time this has been extended for a year.*

DIVISION 7A CHANGES - COMPANY AND TRUST LOANS

Division 7A is a punitive provision aimed at preventing associates of privately owned companies from accessing or benefiting from retained profits without paying extra tax otherwise payable on distribution. A raft of changes to clarify and simplify the provisions have been deferred to a 1 July 2019 start date.

From that date there will now also be changes to the treatment of undrawn distributions from trusts to companies. Currently these are treated under ATO guidelines as if the undrawn amount were a loan to the trust from the company as at the due date for the tax return of the company for the year of distribution. It is necessary to set it up as a complying Division 7A loan or have the trust pay the entitlement in full before lodgement of next year’s tax return. It is anticipated that the changes may bring forward the point of the deemed loan to the time of the trust distribution.

Comment:

- *Division 7A is a persistent and costly nuisance to small business and investment entities. It could easily be made redundant by decent tax reform.*

INCREASED FUNDING TO ATO TO IMPLEMENT SINGLE TOUCH PAYROLL

From 1 July 2018, employers with 20 or more employees will be required to send payroll data to the ATO in real time (i.e. every time a pay run is processed) under the new **Single Touch Payroll (STP)** reporting system.

It is proposed that this system, subject to the introduction and passing of legislation, will extend to all employers from 1 July 2019. The proposal will mean that payroll will need to be processed through a compatible STP electronic payroll system by all employers and manual systems will no longer be acceptable. The budget provides the ATO with an additional $15m over 3 years (from 1 July 2018) to support small businesses with fewer than 20 employees during the transition to STP reporting from 1 July 2019.

At this stage STP is a reporting system only. It will not change the frequency of your payroll cycle, or the due date for payment of your PAYG withholding and superannuation obligations. (There is speculation however that eventually the ATO will move towards real time payment of employer obligations too). The ATO's big selling point under STP is that at year end there will no longer be a requirement to issue PAYG Payment summaries for information reported through STP as the ATO will already have cumulative payroll data at year end. Further, employees will be able to access their year-to-date and year-end payroll information through their MyGov account, or alternatively through the ATO or their tax agent.

Comment:

- *The practicalities of this remain to be seen however success of the system will largely be dependent on software providers providing good solutions and being ready on time. It is also likely that the system will add another level of administration for both taxpayers and their tax agents, require small businesses to incur costs to convert to electronic systems, and will provide the ATO with more information for data matching purposes. Correction of any errors will be an important part of the STP reporting system. Failure to correct these errors may increase chances of ATO audit or review.*
- *The ATO have provided an STP get ready checklist which can be found here*

MORE INFORMATION?

If you have any specific concerns about how the budget affects you, please do not hesitate to contact Nick Chancellor. Most changes have July 2019 implementation and can be covered in year-end planning consultations.

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