TAXWISE BUSINESS NEWS

2017-18 BUDGET EDITION **June 2017**
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The 2017-18 Federal Budget

The 2017-18 Federal Budget (the Budget) was handed down on 9 May 2017.

The Budget focuses on boosting the economy and households so that "we live within our means and are able to return the Budget to balance in 2020/21".

The housing affordability crisis is being addressed with a package of tax, superannuation and other measures as the centrepiece of the Budget. The Budget introduces a new tax – the levy on banks. The Budget also includes a range of integrity measures to enhance the integrity of the tax and superannuation system.

The main measures that are likely to affect you are outlined below, together with information about other measures that may be of interest to you. To ensure you know precisely how you may be affected by one or more of these measures, you should consult your tax adviser.

Housing affordability measures

Support through the superannuation system

i) For first home buyers – first home super saver scheme

Individuals will be able to make voluntary contributions into their superannuation of up to $15,000 per year and $30,000 in total, to subsequently be withdrawn and used for a first home deposit. The contributions can be made from 1 July 2017 and must be made within an individual's existing contribution caps.

From 1 July 2018 onwards, the individual will be able to withdraw these contributions and their associated deemed earnings for a first home deposit. The withdrawals will be taxed at an individual's marginal tax rate, less a 30% tax offset.

Under this new first home super saver scheme, both members of a couple can take advantage of this measure to buy their first home together. The scheme is intended to provide an incentive to enable first home buyers to build savings faster for a home deposit, by accessing the tax advantages of superannuation.

ii) For retirees - superannuation contributions from downsizing

From 1 July 2018, a person aged 65 or over will be able to make a non-concessional contribution into superannuation of up to $300,000 from the proceeds of selling their principal residence. They must have owned their principal residence for at least 10 years. Both members of a couple will each be able to make a $300,000 contribution for the same home.

These contributions are in addition to existing rules and caps and are exempt from the age test, work test and the $1.6 million total superannuation balance test for making non-concessional contributions.

Changes for owners of residential rental properties

i) Travel expenses related to residential rental properties disallowed

Deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property will be disallowed from 1 July 2017.

This is an integrity measure to address concerns that many taxpayers have been claiming deductions for travel costs without correctly apportioning costs, or have claimed travel costs that were for private travel purposes.

This measure will not prevent investors from engaging third parties such as real estate agents for property management services. These expenses will remain deductible.

ii) Depreciation deductions limited for residential rental properties

From 1 July 2017, depreciation for plant and equipment costs will be limited to outlays *actually* incurred by investors in residential real estate properties.

This is an integrity measure to address concerns that some plant and equipment items are being depreciated by successive investors in excess of their actual value. Acquisitions of existing plant and equipment items will be reflected in the cost base for capital gains tax (CGT) purposes for subsequent investors.

Plant and equipment items usually include mechanical fixtures or items which can be "easily" removed from a property, such as dishwashers and ceiling fans.

These changes will apply on a prospective basis, with existing investments grandfathered. Plant and equipment forming part of residential investment properties as of Budget night (including contracts already entered into at 7:30pm (AEST) on 9 May 2017) will continue to give rise to deductions for the asset, or the asset reaches the end of its effective life.

Investors who purchase plant and equipment for their residential investment property after 9 May 2017 will be able to claim a deduction over the effective life of the asset. However, subsequent owners of a property will be unable to claim deductions for plant and equipment purchased by a previous owner of that property.

Encouraging investment in affordable housing

i) Managed investment trusts being encouraged to invest in affordable housing

Managed investment trusts (MITs) will now be able to invest in affordable housing and are being incentivised to do so by allowing investors to receive concessional tax treatment.

MITs allow investors to pool funds to invest in primarily passive investments and cannot carry on or control an active trading business. Non-resident investors are generally subject to a 15% final withholding tax rate on fund payments from an MIT where they are resident of a country with which Australia has an effective exchange of information treaty. Resident investors are taxed at marginal rates and their capital gains are eligible for the CGT discount.

From 1 July 2017, MITs will be able to acquire, construct or redevelop property for the purpose of providing affordable housing, but must satisfy the following conditions:

- the MIT must derive at least 80% of its assessable income from affordable housing in an income year. Up to 20% of income may be derived from other eligible investment activities permitted under the existing MIT rules. If either of these requirements are not satisfied, non-resident investors will be liable to pay withholding tax at a rate of 30% of investment returns for that income year;
- qualifying housing must be provided to low to moderate income tenants;
- rent is to be charged at a discount below the private market rental rate; and
- the affordable housing must be available for rent for at least 10 years. If a property is not held for rent as affordable housing for at least 10 years, net capital gains arising on its disposal will attract a 30% withholding tax rate.

This measure will apply to income years starting on or after 1 July 2017 and is intended to increase private investment in affordable housing. It is estimated to have an unquantifiable cost to revenue over the forward estimates period and the ATO will be provided $1.5 million to implement the measure.

ii) Australian resident individuals being encouraged to invest in affordable housing with an increased CGT discount

The CGT discount will be increased from 50% to 60% for Australian resident individuals investing in qualifying affordable housing.

The conditions to access the 60% discount are:

- the housing must be provided to low to moderate income tenants;
- rent must be charged at a discount below the private rental market rate;
- the affordable housing must be managed through a registered community housing provider; and

- the investment must be held for a minimum period of three years.

This measure will apply from 1 January 2018.

The higher discount will flow through to resident individuals investing in affordable housing via MITs as part of the tax measure enabling such trusts to invest in affordable housing (see above).

CGT main residence exemption removed for foreign and temporary residents

Individuals who are foreign or temporary tax residents will no longer have access to the CGT main residence exemption from 7.30pm (AEST) on 9 May 2017.

Existing properties held before this date will be grandfathered until 30 June 2019.

Measures applying to foreign investors

i) Expansion of foreign resident CGT withholding regime

The CGT withholding rate that applies to foreign tax residents will be increased from 10% to 12.5% from 1 July 2017.

Currently, the foreign resident CGT withholding obligation applies to Australian real property and related interests valued at $2 million or more. This threshold will be reduced to $750,000 from 1 July 2017, increasing the range of properties and interests that will come within this obligation.

ii) Annual levy for foreign-owned vacant residential properties

Foreign owners of vacant residential property, or property that is not genuinely available on the rental market for at least six months per year, will be charged an annual levy of at least $5,000. The annual levy will be equivalent to the relevant foreign investment application fee imposed on the property when it was acquired.

The measure will apply to persons who make a foreign investment application for residential property from Budget night.

iii) Foreign ownership in new developments restricted to 50%

A 50% cap on foreign ownership in new developments will be introduced through a condition on new dwelling exemption certificates. The cap will be included as a condition on new dwelling exemption certificates where the application was made from 7:30pm (AEST) on 9 May 2017.

New dwelling exemption certificates are granted to property developers and act as a 'pre-approval' allowing the sale of new dwellings in a specified development to foreign persons (without each foreign purchaser seeking their own foreign investment approval). The current certificates do not limit the amount of sales that may be made to foreign purchasers.

The measure will ensure that a minimum proportion of developments are available for Australians to purchase.

iv) Integrity measure for foreign resident CGT regime

The principal asset test in Division 855 of the *Income Tax Assessment Act 1997* (Cth) will be applied on an associate inclusive basis for foreign tax residents with indirect interests in Australian real property. The test is relevant to determine whether a foreign resident's asset is a taxable Australian property.

This measure will apply from Budget night and is intended to ensure that foreign tax residents cannot avoid a CGT liability by disaggregating indirect interests in Australian real property.

Individuals

Medicare levy increasing from 2.0% to 2.5% in 2019

The Medicare levy will be increased from 2.0% to 2.5% of taxable income from 1 July 2019. Other tax rates that are linked to the top personal tax rate, such as the fringe benefits tax rate, will also be increased.

Low income earners will continue to receive relief from the Medicare levy through the low income thresholds for singles, families, seniors and pensioners. The current exemptions from the Medicare levy will also remain in place.

All revenue generated by the Medicare levy will be used to support the National Disability Insurance Scheme (NDIS) and to guarantee Medicare. For example, $9.1 billion will be credited over the forward estimates period to the NDIS Savings Fund Special Account when it is established.

This measure is estimated to have a gain to tax revenue of $8.2 billion over the forward estimates period (across all heads of revenue, not just the Medicare levy).

Medicare levy — low-income thresholds to increase

The Medicare levy low-income thresholds for singles, families, and seniors and pensioners will increase from the 2016-17 income year.

The threshold for singles will increase to $21,655 (up from $21,335 for the 2015-16 year).

The family threshold will increase to $36,541 (up from $36,001 for the 2015-16 year).

For single seniors and pensioners, the threshold will increase to $34,244 (up from $33,738 for the 2015-16 year). The family threshold for seniors and pensioners will increase to $47,670 (up from $46,966 for the 2015-16 year).

The child-student component of the income threshold for all families will increase to $3,356 (up from $3,306 for the 2015-16 year).

The increases take into account movements in the consumer price index so that low-income taxpayers generally continue to be exempted from paying the Medicare levy.

This measure is estimated to have a cost to revenue of $180 million over the forward estimates period.

Small business

Small business CGT breaks to be tightened

Access to the small business CGT concessions will be tightened from 1 July 2017 to deny eligibility for assets which are unrelated to the small business.

Small business CGT concessions assist owners of small businesses by providing relief from CGT on assets related to their business which helps them to re-invest and grow, as well as contribute to their retirement savings through the sale of the business.

However, some taxpayers have been able to access these concessions for assets which are unrelated to their small business by, for example, arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.

The small business CGT concessions will continue to be available to small business taxpayers with aggregated turnover of less than $2 million or business assets of less than $6 million.

Instant asset write-off and other depreciation measures from 2015-16 Budget extended

To improve cash flow for small businesses and provide a boost to small business activity and investment, the Government is extending the $20,000 instant asset write-off for small business by 12 months to 30 June 2018. Businesses with an aggregated annual turnover of less than $10 million will be eligible for this concession.

Small businesses will be able to immediately deduct purchases of eligible depreciating assets costing less than $20,000 provided they are first used, or installed ready for use, by 30 June 2018. Only a few assets are ineligible (such as horticultural plants and in-house software).

Depreciating 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% for 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).

The current “lock out” laws from the simplified depreciation rules will also continue to be suspended until 30 June 2018. These rules prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out.

From 1 July 2018, the immediate deductibility threshold, and the balance at which the pool can be immediately deducted, will revert back to $1,000.

Superannuation

LRBAs included in superannuation balance and transfer balance cap

From 1 July 2017, the use of limited recourse borrowing arrangements (LRBAs) will be included in a member’s total superannuation balance and transfer balance cap.

LRBAs can be used to circumvent contribution caps and effectively transfer growth in assets from the accumulation phase to the retirement phase that is not captured by the transfer balance cap. The outstanding balance of an LRBA will now be included in a member’s annual total superannuation balance and the repayment of the principal and interest of an LRBA from a member’s accumulation account will be a credit in the member’s transfer balance account.

Related party transactions to increase superannuation reduced

Opportunities for members to use related party transactions on non-commercial terms to increase superannuation savings will be reduced from 1 July 2018.

The non-arm's length income provisions will be amended to ensure expenses that would normally apply in a commercial transaction are included when considering whether the transaction is on a commercial basis.

GST

Purchasers of new residential properties to remit GST

From 1 July 2018, purchasers of newly constructed residential properties or new subdivisions will be required to remit the GST directly to the ATO as part of the settlement.

Under the current law (where the GST is included in the purchase price and the developer remits the GST to the ATO), some developers have been failing to remit the GST to the ATO despite having claimed GST credits on their construction costs. The new measure is an integrity measure to strengthen compliance with the GST law and will ensure the relevant GST amounts will be remitted.

Double taxation of digital currency removed

Starting on 1 July 2017, the GST treatment of digital currency (such as Bitcoin) will be aligned with the GST treatment of money. This measure will ensure purchases of digital currency are no longer subject to GST.

Digital currency is currently treated as intangible property for GST purposes. Consequently, consumers who use digital currencies as payment can effectively bear GST twice: once on the purchase of the digital currency as it is currently treated as subject to GST, and again on its use in exchange for other goods and services that are subject to GST.

Removing double taxation on digital currencies will remove an obstacle for the financial technology (fintech) sector to grow in Australia.

Tax integrity measures

Bringing tax integrity in the Black Economy

The Government will introduce the following measures to bring integrity into the Black Economy:

i) From 1 July 2018, the taxable payment reporting system (TPRS) will be extended to two high-risk industries — cleaning and couriers — to ensure payments made to contractors in these sectors are reported to the ATO. The first report will be due in August 2019

ii) Additional funding of $32 million will be provided to the ATO for ATO audit and lodgement activities to better target Black Economy risks. This measure is estimated to have a net gain to the budget of $447.2 million over the forward estimates period. The revenue includes an additional GST component of $109.8 million which will be paid to the States and Territories

iii) The manufacture, distribution, possession, use or sale of sales suppression technology will be banned. This technology allows businesses to understate their income and has been identified as a threat to the integrity of the tax system.

Other tax changes

Major bank levy to be introduced

From 1 July 2017, a major bank levy (the levy) will be introduced for authorised deposit taking institutions (ADIs), with licensed entity liabilities of at least $100 billion.

The levy will be calculated quarterly as 0.015% of an ADI's licensed entity liabilities as at each quarterly reporting date mandated by the Australian Prudential Regulation Authority (APRA). This equates to an annualised rate of 0.06%.

The $100 billion threshold will be indexed to grow in line with nominal gross domestic product.

Liabilities subject to the levy will include items such as corporate bonds, commercial paper, certificates of deposit, and Tier-2 capital instruments. The levy will not apply to the following liabilities: additional Tier-1 capital, and deposits of individuals, businesses and other entities protected by the Financial Claims Scheme. It will not be levied on mortgages.

Superannuation funds and insurance companies will not be subject to the levy.

The levy is forecast to raise $6.2 billion over the forward estimates period, net of interactions with other taxes (principally corporate income taxes). The levy is designed to assist with budget repair and to provide a more level playing field for smaller banks and non-bank competitors. It complements prudential reforms being implemented by the government and APRA.

To facilitate the introduction of the levy, the Australian Competition and Consumer Commission (ACCC) will undertake a residential mortgage pricing inquiry until 30 June 2018. As part of this inquiry, the ACCC will be able to require relevant ADIs to explain changes or proposed changes to residential mortgage pricing, including changes to fees, charges, or interest rates by those ADIs.

Skilling Australians Fund levy introduced

Businesses that employ foreign workers on certain skilled visas will be required to pay a levy that will provide revenue for a new Skilling Australians Fund from March 2018.

Businesses with turnover of less than $10 million per year (ie small businesses) will be required to make an upfront payment of $1,200 per visa per year for each employee on a Temporary Skill Shortage visa and make a one-off payment of $3,000 for each employee being sponsored for a permanent Employer Nomination Scheme (subclass 186) visa or a permanent Regional Sponsored Migration Scheme (subclass 187) visa.

Businesses with turnover of $10 million or more per year will be required to make an upfront payment of $1,800 per visa per year for each employee on a Temporary Skill Shortage visa and make a one-off payment of $5,000 for each employee being sponsored for a permanent Employer Nomination Scheme (subclass 186) visa or a permanent Regional Sponsored Migration Scheme (subclass 187) visa.

The levy will replace the current training benchmark financial obligations for employers of workers on Temporary Work (Skilled) (subclass 457) visas, which are being abolished, and permanent Employer Nomination Scheme (subclass 186) Direct Entry stream visas.