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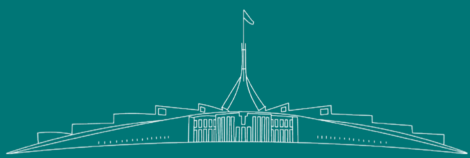

Federal Budget 2019-20

A middle-market perspective

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3 April 2019

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Overview

The 2019-20 Budget has been designed to ensure few in the community will be offended.

The Government is firmly in election mode, spruiking its perceived Budget winners and its economic credentials. The question remains, will this be enough to sway the Australian electorate, and overhaul the 5% deficiency in the current polls?

Some of the key impacts for businesses and stakeholders across Australia, if Budget measures become law, include:

- a 20% increase in the immediate asset write-off to $30,000 for businesses that turnover less than $50m;
- a six-year staged reduction in the marginal tax rate from 32.5% to more closely align with the corporate tax rate, which is hoped to stimulate consumer spending;
- a low-income taxpayer's receipt of $1,080 per individual (or $2,160 for dual income families) from an increase in the low-income offset for individuals; and
- stimulation of activity in the infrastructure construction sector.

Pitcher Partners' pleas on behalf of privately-owned middle market businesses have not gone unheard, with the Government acting to drop the proposed draconian Division 7A measures announced by Treasury in October 2018. Those proposals were riddled with implementation issues at a significant cost to private business owners. The Government has now promised a more consultative and measured process in reforming these laws, reverting to the original objectives of the targeted reforms first articulated in Budget 2016-17.

Concealed with a budget that seeks not to offend, the real losers are state governments, with implications for business and voters. Treasury papers forecast a loss in GST revenue of $10.3 billion compared to prior estimates, impacting state budgets in coming fiscal periods. How states will deal with this when faced with the prospect of declines in receipts from property transactions and valuation taxes and levies, remains to be seen. However, do not expect payroll or duty relief in the upcoming state budget cycle.

The Budget 2019-20 is built on Treasury forecasts for the economy for the coming three years. Examination of these forecasts will reduce confidence among SMEs. While the Government maintained economic growth (albeit slowing from previous forecasts, and below 3%), the Treasury projects an 11% contraction in dwelling investments over 2019-21, which Government expects to offset through stimulus in other business investment. Specifically, price and wage growth resulting from maintenance of employment levels, together with 'productivity improvements', is expected to stimulate economic activity. Historically, slowdown in the housing sector has had negative implications for the middle market.

Government focus on business tax compliance also continues, with ATO compliance programs receiving a funding boost of $1 billion. It is indisputable that those businesses rorting the system should be brought to account. However, increased ATO scrutiny of those already compliant will be increasingly disruptive, and costly, for business.

Disappointingly, for both business and individuals, the Budget lacks significant structural vision. The challenge of re-positioning Australia from digging holes (mining), farming, and construction to value-creation remains absent. While there are programs to progress science, technology, engineering and mathematics (STEM) and apprenticeships, there is limited innovation in the agenda. There is no fundamental shift in education, training or tangible technology development, indicating a poor focus on long-term investment.

Overall the Budget offers little in the way of policy change or structural reform. Government spending on infrastructure is the chosen remedy to a slowing economy and the tool to seduce voters in an imminent election.

Personal income tax

The Government has announced measures that seek to build on previously legislated changes to reduce personal income tax over the next six years.

Low and middle income tax offset (LMITO)

With immediate effect for the 2019 income year, the Government has proposed to increase the non-refundable low- and middle-income tax offset (LMITO) to a maximum amount of $1,080 (up from $530) for taxpayers earning more than $48,000 but no more than $90,000. The LMITO then phases out from $90,001 to $126,000. The base amount of the LMITO is also proposed to increase from $200 to $255 for those earning no more than $48,000. This offset is in addition to the existing low-income tax offset (LITO) and is a temporary measure due to be removed on 30 June 2022.

Tax rate changes

With effect from 1 July 2022, the Government proposes to increase the top threshold of the 19% tax bracket from the previously legislated $41,000 to $45,000 and will also increase the LITO from the previously legislated amount of $645 to $700. These changes are intended to lock in the reduction in tax provided by the LMITO, once the LMITO is removed.

The Government has already legislated to remove the 37% tax bracket with effect from 1 July 2024. In this Budget, it announced a further change to reduce the 32.5% marginal tax rate to 30%, which will take effect at the same time. This means that taxpayers earning up to $200,000 will pay a maximum marginal tax rate of 30% from the 2025 income year. For that year, taxpayers will be able to earn fully franked dividends of approximately $158,000 without paying any top-up tax (assuming a franking rate of 30%) and approximately $90,000 (assuming a franking rate of 25%).

Tax rates and thresholds for 2018-19 onwards

The table below summarises the announced personal tax rate and threshold changes (excluding the 2% Medicare levy).

Tax rates and thresholds			
Rate	**2018-19**	**2022-23**	**2024-25**
0%	$0 - $18,200	$0 - $18,200	$0 - $18,200
19%	$18,201 - $37,000	$18,201 - $45,000	$18,201 - $45,000
30%	N/A	N/A	$45,001 - $200,000
32.5%	$37,001 – $90,000	$45,001 – $120,000	N/A
37%	$90,001 – $180,000	$120,001 – $180,000	N/A
45%	$180,001+	$180,001+	$200,001+
LITO	Up to $445	Up to $700	Up to $700
LMITO	Up to $1,080		

Medicare levy low-income thresholds for 2018-19

For the 2018-19 income year, the Medicare levy low-income threshold for singles will be increased to $22,398 (up from $21,980 in 2017-18). For couples with no children, the family income threshold will be increased to $37,794 (up from $37,089 in 2017-18). For each dependent child or student, the family income threshold will increase by $3,471 (up from $3,406 in 2017-18).

For single seniors and pensioners eligible for the seniors & pensioners tax offset, the Medicare levy low-income threshold will be increased to $35,418 (up from $34,758 in 2017-18). The family threshold for seniors and pensioners will be increased to $49,304 (up from $48,385), plus $3,471 for each dependent child or student.

Private tax

The Government has heeded concerns and delayed the start date of Division 7A changes for 12 months

Further consultation on Division 7A

The Government has delayed the proposed start date of changes to Division 7A by a year, to commence on 1 July 2020, rather than 1 July 2019. The delayed start date is to allow time to further consider stakeholders' views on the Treasury consultation paper released in October 2018.

In a submission to Government, Pitcher Partners raised serious concerns that the proposed changes to Division 7A would make it harder for middle market businesses to comply with the provisions and conduct their businesses, particularly in cases where there is no private use of funds. In particular, Pitcher Partners highlighted a number of proposals by Treasury that appeared especially restrictive, such as amendments to the requirements for complying loans, removal of the distributable surplus concept, extending the ability for the ATO to amend tax returns from 4 years to 14 years, removing grandfathering of pre-existing arrangements, shortening of 25-year secured loan arrangements, and increasing the benchmark interest rates from (circa) 5% per annum to (circa) 10% per annum for business related loans. It is positive that the Government has listened to these concerns.

Importantly, the Government has announced it will engage in further consultation to ensure appropriate treatment of transitional arrangements, so taxpayers are not unfairly prejudiced. The Government will reconsider how existing concessional arrangements (such as pre-1997 loans, pre-2009 unpaid trust entitlements, post-2009 unpaid trust entitlements and 25-year secured loans) will be treated when brought into the new regime.

The delayed commencement date gives taxpayers additional time to consider their existing arrangements and may, depending on the result of further consultation, allow existing or new concessional arrangements to remain in place.

Small and medium business tax

The Government has announced an expansion of the instant asset write-off threshold from $25,000 to $30,000, with medium-sized businesses (with a turnover of up to $50m) now also qualifying. Further, additional funding of $60 million will be provided over three years for small and medium enterprises to support Australian exports.

Instant asset write-off

Following the Government's announcement on 29 January 2019 to increase the instant asset write-off threshold to $25,000 and extend the eligible purchase period to 30 June 2020, this Budget announcement increases the threshold even further to apply to assets costing less than $30,000, while retaining the 30 June 2020 deadline.

While the deduction measure was previously limited to small businesses (being those businesses with an aggregated annual turnover of less than $10 million), it will soon extend to "medium-sized business" with an aggregated turnover of less than $50 million. This means all businesses with an aggregated turnover of less than $50 million will be able to obtain an immediate deduction for eligible assets costing less than $30,000 that are first used, or installed ready-for-use, from Budget night to 30 June 2020.

We note that the instant asset write-off for medium-sized businesses will only apply to assets that were acquired after 2 April 2019 and will not apply to assets acquired before this date (even where they are first used or installed ready for use after Budget night).

Given the announcements made on 29 January 2019, there are effectively three different thresholds that will apply for purchases made during the 2019 financial year. In summary, the immediate deduction will be available in respect of assets that cost:

- up to $20,000, purchased from 1 July 2018 to 28 January 2019 (for small business)
- up to $25,000, purchased from 29 January 2019 to 2 April 2019 (for small business)
- up to $30,000, purchased from 2 April 2019 to 30 June 2020 (for both small and medium-sized business)

The Budget announcement makes it clear that the existing small business tax depreciation concessions, including the pooling rules, will continue to apply to those businesses with aggregated turnover of less than $10 million, and will not be extended to medium sized businesses.

The expansion of the instant asset write-off to medium-sized businesses is a positive outcome for those businesses otherwise overlooked in this year's budget. This measure will help to provide moderate cash flow benefits to an estimated 22,000 additional businesses.

Export Market Development Grant (EMDG)

The Government announced that it will provide additional funding of $60 million to the EMDG scheme over a three-year period to support small and medium enterprises (SMEs) that export Australian goods and services to overseas markets.

The EMDG is currently available to Australian exporters who have income of less than $50 million and who promote their products to international customers. The objective of the EMDG is to reimburse eligible entities up to 50% of their promotional expenses (i.e. advertising, marketing, overseas travel to trade shows) incurred above $15,000. The minimum grant entitlement is $5,000 and the maximum is $150,000 per annum.

Whilst not significant, the additional funding will assist those Australian small business entities looking to build and expand their brand overseas.

International tax

After years of significant amendments to international tax provisions, this year's budget is relatively quiet from an international perspective.

Technical amendments to the hybrid mismatch rules

Australia has introduced hybrid mismatch provisions that generally apply to international transactions seen to provide double benefits to taxpayers, with effect for income years commencing on or after 1 January 2019. These double benefits can include claiming deductions in two jurisdictions or claiming a deduction in one jurisdiction with no income taxed in another. The hybrid mismatch rules do not contain any exceptions for individuals or small or medium sized business and can potentially apply to almost all international tax transactions. While the provisions state they are targeted at "multinational corporations", the provisions can potentially apply to an individual with a foreign rental property where the deductions claimed are as little as $100.

Instead of addressing the middle market's concerns regarding the complexity and potential unintended reach of the rules, the Government has announced it will make technical corrections that will likely expand the application of the provisions. The announcements are aimed at dealing with more complex arrangements such as those involving Multiple Entry Consolidated (MEC) groups and trusts, will seek to further limit the meaning of foreign tax, and will specify that the integrity rule (targeting the use of interposed low-rate lenders) can apply where other provisions have applied.

It is disappointing that the Government has not taken the opportunity to provide a carve out for unintended impacts on the middle market, meaning businesses will incur significant compliance costs in assessing the scope of these provisions.

Australia and Israel tax treaty

Australia and Israel signed an income tax treaty on 28 March 2019, which will come into effect in Australia when the relevant approvals are obtained. Features of the treaty include reduced rates of dividend, interest and royalty withholding tax.

Given the volume of trade and investment that exist between the two jurisdictions, Australia's 45th income tax treaty is a welcome addition to our existing tax treaty network. We believe this will further encourage significant investment in technology and start-up businesses throughout both jurisdictions.

Updating the list of information exchange countries

The Government has added eight new exchange of information agreements, increasing the number of information exchange countries from 114 to 122. Australia first entered into these agreements in 2018. The update will be effective from 1 January 2020.

The new jurisdictions are Curaçao, Lebanon, Nauru, Pakistan, Panama, Peru, Qatar and the United Arab Emirates.

From 1 January 2020, fund payments made by withholding Managed Investment Trusts (MITs) to investors in these jurisdictions should generally be eligible to access the reduced 15% MIT withholding tax rate, instead of the default rate of 30%.

Superannuation

The Government has again announced superannuation changes in this year's Budget, which are broadly positive in nature and aimed at increasing contribution opportunities for individuals between the ages of 65 and 74.

Work test exemption for individuals aged 65 and 66

The Government has stated that from 1 July 2020, individuals aged 65 and 66 will be permitted to make voluntary superannuation contributions without satisfying the work test requirement.

Currently, contributions by those aged 65 and over are subject to a work test that requires the person to have worked a minimum of 40 hours in a consecutive 30-day period during the financial year.

Extending voluntary contribution opportunities to individuals who may otherwise miss out because they are not participating in regular paid work is a welcome initiative. These changes have limited practical application for those with existing superannuation balances over $1.6 million.

By way of example, for an individual with a superannuation balance of $1 million, the change could enable an additional $450,000 (through a combination of concessional and non-concessional contributions over a period of two years) to be contributed that would otherwise not have been permitted under current rules. If an individual's superannuation balance is already above $1.6 million, additional contributions will likely be limited to annual concessional contributions of only $25,000.

Extension of bring-forward contribution eligibility

In addition to the work test exemption, the Government has stated it would also permit "bring-forward" contributions for individuals aged 65 and 66. The ability to bring forward contributions is not currently available once an individual has reached age 65.

On a practical level, the measure would extend access to bring-forward contributions for an additional two years of an individual's life. Bring-forward contributions allow individuals to use three years of non-concessional contributions in any one year – i.e. non-concessional contributions of up to $300,000 could be made in one financial year, significantly boosting superannuation fund assets available for investment.

The measure complements the work test exemption changes and is also stated to apply from 1 July 2020.

Extension of age limit for spouse contributions

Rounding out the limited extension of contribution opportunities for self-funded retirees is a proposal to extend eligibility for spouse contributions to age 74 from 1 July 2020. Currently, spouse contributions are not permitted from age 70. Given that currently a spouse can make personal contributions to the age of 74 (subject to other conditions), this measure may have limited benefits unless qualification is also satisfied for the spouse tax offset (i.e. currently where your spouse's income is less than $40,000).

Reducing compliance costs for some pension funds

Currently, a portion of the income of a superannuation fund paying pensions may be exempt from tax (i.e. under the exemption current pension income [ECPI] rules).

The Government announced an intention to simplify the process of administering and calculating ECPI for superannuation funds paying pensions. Under the rules, a superannuation fund may be required to apply different methods within the one income year. The proposed measures would permit relevant superannuation funds to apply a single calculation method, which would simplify compliance with these provisions. The measures would also remove any need for eligible superannuation funds to obtain an actuarial certificate to support the fund's ECPI claim where the superannuation fund only pays pensions throughout the year. The changes are stated to apply from 1 July 2020.

Other superannuation announcements

The Government also announced that it will provide permanent tax relief for large superannuation funds undertaking mergers. The current applicable exemptions that were due to expire from 1 July 2020 will now apply indefinitely.

Indirect tax

The Budget did not contain major changes to indirect taxes but announced a small change to the luxury car tax for farmers and tourism operators. The Budget also proposed measures to counter the black economy through more stringent (annual) ABN eligibility rules.

ABN integrity measures

The Government has announced that from 1 July 2021, ABN holders with an income tax return obligation will need to lodge their income tax return to retain their ABN. From 1 July 2022, ABN holders will also need to confirm the accuracy of their details on the ABR register on an annual basis.

These changes will enact some of the measures recommended by the Black Economy Taskforce, which identified widespread abuse of ABNs. The devil will be in the detail as to how this measure will apply. The deferred lodgement due dates that apply to certain taxpayers are likely to make the practical implementation of this measure challenging.

The change will also impose an additional compliance burden on businesses to ensure the currency of the ABN of their suppliers. Where a supplier's ABN is cancelled, a payer could unwittingly find themselves with a no-ABN withholding obligation. The Government must ensure that innocent taxpayers are protected from unexpected consequences.

Increased luxury car tax refunds

Farmers and tourism operators who use luxury vehicles in their business are currently able to access refunds of up to $3,000 of the luxury car tax (LCT) paid. From 1 July 2019, the LCT refund limit will be increased to $10,000.

Tax integrity measures

The Budget provides more funding to the ATO's Tax Avoidance Taskforce with a focus on unpaid tax and superannuation by large businesses and high wealth individuals. A dedicated sham contracting unit will also be created within the Fair Work Ombudsman to address sham contracting.

Tax Avoidance Taskforce

From 2019-20, the Government will provide the ATO with an additional $1.0 billion in funding over four years to extend the operation of the Tax Avoidance Taskforce and to expand the Taskforce's programs and market coverage. The additional funding is expected to result in increased tax receipts of $3.6 billion over the forward estimates period.

The Taskforce undertakes compliance activities targeting multinationals, large public and private groups, trust and high wealth individuals. This measure is aimed to expand its activities, as well as increasing its scrutiny of specialist tax advisors and intermediaries who promote tax avoidance schemes and strategies.

Focus on unpaid tax and super by larger businesses

The Government will provide the ATO with $42.1 million over four years to increase activities to recover unpaid tax and superannuation liabilities. These activities will focus on larger business and high wealth individuals to ensure on-time payment of their tax and superannuation liabilities. This measure will not extend to small business.

This measure is in keeping with the recent increased focus of the Government and the ATO in addressing non-compliance with tax and superannuation obligations.

Dedicated unit to be established

From 2019-20, $9.2 million will be provided over four years to establish a dedicated sham contracting unit within the Fair Work Ombudsman. The unit will address sham contracting behaviour by those who knowingly or recklessly misrepresent employment relationships as independent contracts to avoid statutory obligations and employment entitlements. The unit will address sham contracting by increasing education, compliance and enforcement activities, and dedicating additional resources to, not only investigate, but also litigate cases.

The establishment of this unit is a further indication of the Government's desire to arrest sham contracting to ensure employers meet their legal and taxation obligations.

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