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PERSONAL TAXATION

Personal tax rates: staged seven-year reform plan starting from 2018–2019

In the 2018–2019 Budget, the Government announced staged tax relief for low and middle income earners. The Government is proposing a major seven-year, three-step plan to reform personal income tax.

Step 1 will see a new, non-refundable low and middle income tax offset from 2018–2019 to 2021–2022, designed to provide tax relief of up to \$530 for each of those years. The offset will be delivered on assessment after an individual submits their tax return, and will be in addition to the existing low income tax offset (LITO).

The low and middle income tax offset will provide a benefit of up to \$200 for taxpayers with taxable income of \$37,000 or less. Between \$37,000 and \$48,000 of taxable income, the value of the offset will increase at a rate of three cents per dollar to the maximum benefit of \$530. Taxpayers with taxable incomes from \$48,000 to \$90,000 will be eligible for the maximum benefit of \$530. From \$90,001 to \$125,333 of taxable income, the offset will phase out at a rate of 1.5 cents per dollar.

Step 2 will increase the top threshold of the 32.5% tax bracket from \$87,000 to \$90,000 from 1 July 2018. In 2022–2023, the top threshold of the 19% bracket will increase from \$37,000 to \$41,000 and the LITO will increase from \$445 to \$645. The increased LITO will be withdrawn at a rate of 6.5 cents per dollar between incomes of \$37,000 and \$41,000, and at a rate of 1.5 cents per dollar between incomes of \$41,000 and \$66,667. The top threshold of the 32.5% bracket will increase from \$90,000 to \$120,000 from 1 July 2022.

Step 3: from 1 July 2024, the top threshold of the 32.5% bracket will increase from \$120,000 to \$200,000, removing the 37% tax bracket completely. Taxpayers will pay the top marginal tax rate of 45% from taxable incomes exceeding \$200,000 and the 32.5% tax bracket will apply to taxable incomes of \$41,001 to \$200,000.

The Government says this means that around 94% of all taxpayers are projected to face a marginal tax rate of 32.5% or less in 2024–2025.

Medicare levy, 2017–2018 tax rates unchanged

The Government had proposed to increase the Medicare levy from 2% to 2.5% from 1 July 2019, but has decided not to proceed with this. Presumably the Bills to do this, which are currently before Parliament, will be removed. In an address on 26 April 2018 to the Australian Business Economists in Sydney, the Treasurer said that, due to the improving economy and fiscal position, the Government is “now in a position to give our guarantee to Australians living with a disability and their families and carers that all planned expenditure on the National Disability Insurance Scheme (NDIS) will be able to be met in this year’s Budget and beyond without any longer having to increase the Medicare levy”.

At the same time, it has been reported that Shadow Treasurer Chris Bowen has announced that Labor will not proceed with its proposal to increase the Medicare levy by 0.5% (to 2.5%) on those earning above \$87,000.

The tax rates and thresholds for the 2017–2018 year remain unchanged.

BUSINESS TAXATION

\$20,000 instant asset write-off for SBEs extended by 12 months

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 2017 and 30 June 2019 and first used or installed ready for use by 30 June 2019 for a taxable purpose. Only a few assets are not eligible for the instant asset write-off or other simplified depreciation rules (eg horticultural plants and in-house software).

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).

The current “lock out” laws for the simplified depreciation rules (which prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out) will continue to be suspended until 30 June 2019.

The instant asset write-off threshold and the threshold for immediate deductibility of the balance of the pool will revert to \$1,000 on 1 July 2019.

While the extension of the write-off will be welcomed, SBEs of course need to have the cash-flow to enable them to spend the \$20,000 in the first place.

Anti-avoidance rules: family trust circular distributions

The Government will extend specific anti-avoidance rules that apply to other closely held trusts that engage in circular trust distributions to family trusts.

Currently, where family trusts act as beneficiaries of each other in a round-robin arrangement, a distribution can ultimately be returned to the original trustee in a way that avoids any tax being paid on that amount. The measure will allow ATO to pursue family trusts that engage in these arrangements and impose tax on such distributions at a rate equal to the top personal rate plus the Medicare levy.

This measure applies from 1 July 2019.

Deductions disallowed for holding vacant land

The Government will disallow deductions for expenses associated with holding vacant land. Where the land is not genuinely held for the purpose of earning assessable income, expenses such as interest costs will be denied. It is hoped this measure will reduce the tax incentives for land banking which limit the use of land for housing or other development.

The measure will apply to both land held for residential and commercial purposes. However, the “carrying on a business” test would generally exclude land held for a commercial development. It 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 available for rent; or
- the land is being used by the owner to carry on a business, including a business of primary production.

Disallowed deductions will not be able to be carried forward for use in later income years. Expenses for which deductions will be denied could be included in the cost base if it would ordinarily be a cost base element (ie borrowing costs and council rates) for CGT

purposes. However, if the denied deductions are for expenses would not ordinarily be a cost base element, they cannot be included in the cost base.

This measure applies from 1 July 2019.

Partnerships: enhancing integrity of concessions

Partners that alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership will no longer be able to access the small business capital gains tax (CGT) concessions in relation to these rights.

The Government said this measure will prevent taxpayers, including large partnerships, inappropriately accessing the CGT small business concessions in relation to their assignment to an entity of a right to the future income of a partnership, without giving that entity any role in the partnership.

There are no changes to the small business CGT concessions themselves. The concessions will continue to be available to eligible small businesses with an aggregated annual turnover of less than \$2 million or net assets less than \$6 million.

These measures will apply from 7:30PM (AEST) on 8 May 2018.

TAX COMPLIANCE AND INTEGRITY

No tax deduction for non-compliant PAYG and contractor payments

Measures will be enacted to ensure that taxpayers will not be able to claim deductions for payments to their employees such as wages where they have not withheld any amount of PAYG from these payments, despite the PAYG withholding requirements applying.

Similarly, the Government intends to remove deductions for payments made by businesses to contractors where the contractor does not provide an ABN and the business does not withhold any amount of PAYG (again despite the withholding requirements applying).

These measures were recommended by the Black Economy Taskforce.

The revenue expectations linked with this expenditure is quite modest – “a small unquantifiable gain to revenue over the forward estimates period”.

The measures will commence on 1 July 2019.

Cash payments limit: payments made to businesses

The Government will introduce a limit of \$10,000 for cash payments made to businesses for goods and services.

This measure will require transactions over a threshold to be made through an electronic payment system or by cheque. Logically it would seem that this threshold

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amount should be \$10,000, but this is not spelt out in the Budget papers or the media release.

The rules will not apply to transactions with:

- financial institutions; or
- consumer-to-consumer non-business transactions.

This measure was recommended by the Black Economy Taskforce. It is designed to support other measures designed to counter the black economy. There is no revenue impact associated with it.

The limit will apply from 1 July 2019. The Government will consult further as part of the implementation process.

Reportable payments system extended: security providers, road freight transport and computer design

The Government will extend the taxable payments reporting system (TPRS) to the following industries:

- security providers and investigation services;
- road freight transport; and
- computer system design and related services.

This will extend the TPRS requirements already applying to the building and construction industry. The TPRS requirements will also be extended, from 1 July 2018, to the cleaning and courier industries under measures contained in the *Treasury Laws Amendment (Black Economy Taskforce Measures No 1) Bill 2018*.

The reporting requirements will apply from 1 July 2019, with the first annual report required in August 2020.

SUPERANNUATION

SMSF member limit to increase from four to six

The Budget confirmed that the maximum number of allowable members in new and existing self managed superannuation funds (SMSFs) and small APRA funds will be expanded from four to six members from 1 July 2019. This measure was originally flagged on 27 April 2018 by the Minister for Revenue and Financial Services, Kelly O'Dwyer.

The proposed increase to the maximum number of SMSF members seeks to provide greater flexibility for large families to jointly manage retirement savings. Given the growth in the sector to date, Ms O'Dwyer said the measure will ensure SMSFs remain compelling retirement savings vehicle. The Government is expected to ask the ATO to work with industry on the design and implementation of this measure. It is not expected to have a revenue impact.

Extra SMSF members to provide flexibility

Currently, s 17A(1)(a) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) requires an SMSF to have fewer than five members. In addition, each

member must be a trustee of the fund (or a director of the corporate trustee). This seeks to ensure that all members are fully involved and equally responsible for fund decisions and investments.

The Government's proposal to allow up to six SMSF members may assist those with larger families to implement intergenerational solutions for managing long-term, capital intensive investments, such as commercial property and business real property. For example, allowing an extra two members provides an opportunity to improve a fund's cash flow by using the contributions of the younger members to make pension payments to the members in retirement phase, without needing to sell a long-term investment.

As each member must be a trustee of the fund, a decision to add extra members should not be taken lightly as it can add complexity to the fund's management and investment strategy. A change to the membership of an SMSF will alter the trustee arrangements which can impact who controls the fund in the event of a dispute. This is especially relevant in the event of the death of a member, as the surviving trustees have considerable discretion as to the payment of the deceased's super benefits (subject to any binding death benefit nomination).

Labor's dividend imputation policy

Allowing up to six SMSF members may assist some SMSFs to implement strategies to guard against Labor's proposal to end cash refunds of excess franking credits from 1 July 2019. SMSFs in tax-exempt pension phase are expected to feel the brunt of Labor's proposal, although an exemption was subsequently announced for SMSFs with at least one Government pensioner or allowance recipient before 28 March 2018.

To avoid wasting non-refundable franking credits, Labor's proposal would create an incentive for SMSFs in pension phase to add additional accumulation phase members (eg adult children) who could effectively make some use of the excess franking credits within the fund. That is, the excess franking credits would be used to absorb some of the 15% contributions tax in relation to the accumulation members. For example, the proposal to increase the maximum number of SMSF members from four to six would enable a typical two-member fund in pension phase to admit up to four adult children as members. If those adult children are making concessional contributions up to the maximum of \$25,000 per year, the fund could use the excess franking credits to offset up to \$15,000 (four x \$25,000 x 15%) in contributions tax each year for the adult children.

This strategy would essentially replicate, to the extent possible, the position of large APRA funds under Labor's policy. APRA funds typically have more contributing members and diverse income sources (beyond franked dividends) that can usually fully absorb the franking credits.

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As already noted, a decision to add additional members to an SMSF may add complexity to the management and control of the fund. This would require professional advice for the specific circumstances of the fund and its members.

Superannuation work test exemption for contributions by recent retirees

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.

Currently, the work test in reg 7.04 of the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) restricts the ability to make voluntary superannuation contributions for those aged 65–74 to individuals who self-report as working a minimum of 40 hours in any 30-day period in the financial year. The measure will give recent retirees additional flexibilities to get their financial affairs in order in transition to retirement. It will apply from 1 July 2019.

SMSF audit cycle of three years for funds with good compliance history

The annual audit requirement for SMSFs will be extended to a three-yearly cycle for funds with a history of good record-keeping and compliance.

The measure will apply to SMSF trustees that have a history of three consecutive years of clear audit reports and that have lodged the fund's annual returns in a timely manner.

This measure will start on 1 July 2019. The Government said it will undertake consultation to ensure a smooth implementation.

Super fees to be capped at 3% for small accounts, exit fees banned

Passive fees charged by superannuation funds will be capped at 3% for small accounts with balances below \$6,000, while exit fees will be banned for all superannuation accounts from 1 July 2019. These measures form part of the Government's *Protecting Your Super Package*.

The Minister for Revenue and Financial Services, Kelly O'Dwyer, said there were around 9.5 million super accounts with a balance less than \$6,000 in 2015–2016. To avoid these small accounts from being eroded, the Government will cap the administration and investment fees at 3% annually, Ms O'Dwyer said.

The Government will also ban exit fees on all superannuation accounts. Exit fees of around \$37 million were charged to members in 2015–2016 to simply close an account with a super fund. The proposed ban on exit fees will also benefit members looking to rollover their super accounts to a different

fund, or who hold multiple accounts and see exit fees as a barrier to consolidating accounts.

With nearly two million low and inactive accounts belonging to women, the Minister said these measures will help to protect the hard-earned super savings of women from undue erosion. These changes will take effect from 1 July 2019.

Superannuation insurance opt-in rule for younger and low-balance members

The Government will change the insurance arrangements for certain cohorts of superannuation members from 1 July 2019. Under the proposed changes, insurance within superannuation will move from a default framework to be offered on an opt-in basis for:

- members with low balances of less than \$6,000;
- members under the age of 25 years; and
- members with inactive accounts that have not received a contribution in 13 months.

These changes seek to protect the retirement savings of young people and those with low balances by ensuring their superannuation is not unnecessarily eroded by premiums on insurance policies they do not need or are not aware of. The Minister for Revenue and Financial Services, Kelly O'Dwyer, said around 5 million individuals will have the opportunity to save an estimated \$3 billion in insurance premiums by choosing to opt-in to this cover, rather than paying for it by default.

The changes also seek to reduce the incidence of duplicated cover so that individuals are not paying for multiple insurance policies, which they may not be able to claim on in any event. Importantly, these changes will not prevent anyone who wants insurance from being able to obtain it. That is, low balance, young, and inactive members will still be able to opt in to insurance cover within super.

In addition, the Government said it will consult publicly on ways in which the current policy settings could be improved to better balance the priorities of retirement savings and insurance cover within super.

The changes will take effect on 1 July 2019. Affected superannuants will have a period of 14 months to decide whether they will opt-in to their existing cover or allow it to switch off.