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Federal Budget 2016: An economic plan, not just another budget

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A pre-election budget is not usually the forum to announce unpopular measures to the voting public and the Treasurer did not disappoint; with a budget that did not target social security recipients at all but instead launched into the superannuation equity debate, by attacking tax-effective wealth creation for the wealthy with some critical changes announced.

In this special federal budget edition of Financial Insights, we have listed the main proposals of the 2016 Federal Budget, commenting on those measures which most impact upon you in your financial journeys.

In delivering his, and Prime Minter Malcolm Turnbull's first, Federal Budget, Treasurer Scott Morrison said the 2016 Budget sets out the Government's economic plan to ensure Australia continues to successfully transition from the mining investment boom to a stronger, more diversified, new economy in three key ways.

He gave three key undertakings which included;

1. Sticking to the Government's plan for jobs and growth;
2. Fixing problems in the tax system to enable the Government to sustainably cover its responsibilities for the next generation; and
3. Ensuring that the Government lives within its means, to balance the budget and reduce the burden of long-term debt.

In short, the Treasurer said that the people making the economy work were small to medium enterprises (SMEs) and the Budget announced number of changes to support small business, some starting on 1 July 2016.

From a taxation and superannuation point of view, the Budget contained a number of significant announcements. These included modest reform of the tax brackets in an attempt to address tax bracket creep by increasing the $80,000 tax bracket threshold to $87,000, major superannuation changes (balance cap on retirement accounts, lifetime non-concessional contributions cap, transitional to retirement change) a further crackdown on multinational enterprise (MNE) tax avoidance, GST changes on the importation of low-value goods.

The Government also confirmed that the 2% temporary Budget deficit levy (on incomes over $180,000) would expire at the end of the 2016-17 financial year as currently legislated.

In terms of all the pre-Budget speculation on changes to the rate or base of GST, nothing was announced to that effect so the GST story is quiet for now and it can safely be assumed that there would be no change to the GST rate or base in the next term of a Coalition Government.

With an eye on the election, the Treasurer noted that several special appropriation Bills were introduced into the House of Representatives on 2 May 2016 which deal "with the unusual situation we have going to an election on the second of July, that will ensure a continuity of supply over the course of the election period".

Economic numbers

In his Budget Speech, the Treasurer said the deficit in underlying cash balance terms is expected to reduce from $39.9 billion in 2015-16 to $37.1 billion, or 2.2% as a share of the economy in 2016-17. The deficit is then projected to fall to $6.0 billion or just 0.3% of GDP over the next 4 years to 2019-20, achieved through policies that will continue to control spending.

The economy is forecast to grow by 2.5% in both 2015-16 and 2016-17 and to pick up to 3% in 2017-18. The underlying cash balance is expected to improve in each and every year over the forward estimates period, from a deficit of 2.4% of GDP in 2015-16 to 0.3% of GDP in 2019-20. The Government has stated that the budget is projected to return to balance by 2020-21.

Total revenue for 2016-17 is expected to be $416.9 billion, an increase of 5.2% on estimated revenue in 2015-16. Total expenses for 2016-17 are expected to be $450.6 billion, an increase of 4.4% on estimated expenses in 2015-16.

The Government said it has committed a record $50 billion in infrastructure investment between 2013-14 and 2019-20 for roads, rail, airports and dams. The Government expects that there will be no increase in the projected tax burden as a share of the economy, compared to the 2015-16 Budget; and that payments as a share of the economy will fall from 25.8% in 2015-16 down to 25.2% in 2019-20.

An outline of the major revenue-related announcements is given below.

Summary of revenue measures announced

The major revenue measures announced in the Budget included:

- increasing the tax bracket at which the 37% tax rate starts from $80,001 to $87,001, to start from 1 July 2016;
- a phased reduction in the company tax rate over 10 years;
- major SME tax changes - small business threshold to be increased to $10 million, reduced tax rates for small business;
- significant new measures directed at MNE tax avoidance; for example a diverted profits tax, hybrid mismatch measures, strengthened transfer pricing rules, significant increase in administrative penalties;
- superannuation:

  - $1.6m transfer balance cap for retirement accounts;

  - Non-concessional contributions will be subject to a $500,000 lifetime cap from Budget night;

  - Concessional contributions cap cut to $25,000 from 1 July 2017;

  - Concessional contributions catch-up for account balances less than $500,000;

  - Superannuation contributions tax (ie, Div 293 tax) for incomes in excess of $250,000;

  - Transition to retirement income streams - integrity proposal.
- The Government is to impose GST on goods imported by consumers regardless of value.

Superannuation Measures

A Lifetime Non-Concessional Cap

Effective immediately (7:30pm AEST on 3rd May 2016), a lifetime cap of $500,000 will be introduced for non-concessional contributions, to be indexed in $50,000 increments in line with wages. This is expected to give increased flexibility to older people who are currently limited to $180,000 a year.

If an individual has exceeded the cap prior to commencement, they will be deemed to have used up their cap, but will not be required to take the excess out of the superannuation system.

Given few people have made contributions totalling $500,000 or more since 2007, only a small amount will be affected.

This measure will also apply to members of Defined Benefit Schemes and Constitutionally Protected Funds.

Taxation of Concessional Contributions

The annual concessional contributions cap will be lowered from 1 July 2017 to $25,000, indexed in line with wages growth. It is expected that only about 3% of superannuation fund members will be affected by this measure in 2017/18.

The Government will also reduce the income threshold above which a person is required to pay an additional 15% tax on their concessional contributions from $300,000 to $250,000 pa. An estimated 1% of superannuation fund members would be affected by this.

Improved Access to Concessional Contributions

So that more people can utilise their Concessional Contributions cap, from 1 July 2017, all Australians under age 75 will be able to claim an income tax deduction for personal superannuation contributions, up to the cap of $25,000 pa.

Some members of Defined Benefit Schemes and Constitutionally Protected Funds may not be eligible to claim a deduction for contributions to these funds, and may need to direct these contributions to a different fund.

Improve integrity of Transition to Retirement (TTR) Income Streams

The tax exempt status of income from assets that support TTR Income Streams will be removed from 1 July 2017.

Further to this, individuals will no longer be able to treat certain superannuation income stream payments as lump sums for tax purposes. Currently, these would be tax-free up to the low rate cap ($195,000).

Catch Up Concessional Contributions

From 1 July 2017, those with superannuation balances of $500,000 or less can accrue additional concessional cap amounts by essentially carrying forward unused amounts for rolling 5 year periods. After 5 years, any unused amounts will expire.

Extension of the Spouse Tax Offset

From 1 July 2017, eligibility rules for this offset will be extended.

The current tax offset of 18%, up to $540 will be available to an individual contributing to a recipient spouse's superannuation account, whose income is up to $37,000 pa, up from $10,800 and will be phased out at $40,000 pa.

Increased Flexibility and Choice for Older Australians

The rules that limit the ability of those aged 65 – 74 to contribute to theirs or their spouse's superannuation will change.

The requirement to meet a work test before making voluntary or non-concessional contributions to superannuation will be removed, as will the requirement for a spouse to meet a work test for contributions to a spouses superannuation account.

This age group will also benefit from the other superannuation measures announced, including, but not limited to catch-up contributions and the lifetime non-concessional cap.

Introduction of a $1.6m Transfer Balance Cap

From 1 July 2017, it is proposed that a $1.6m cap will be introduced; limiting the amount a person can transfer into a tax free retirement account. This cap will be indexed in $100,000 increments in line with CPI, and a proportionate method will be used to determine how much room a person has available in their cap at a point in time. If the cap is breached, the amount in excess of the cap as well as earnings on the excess amount will be taxed.

It is expected that very few people will be affected by this measure, with the average superannuation balance for a 60 year old being $285,000.

Retirement Income Products

From 1 July 2017, the tax exemption on earnings in retirement phase will be extended to products such as deferred lifetime annuities and group self-annuitisation products that seek to provide people with income through their retirement, regardless of how long they live.

The Government is yet to announce how these products will be assessed by Centrelink.

Low Income Superannuation Tax Offset

From 1 July 2017, the existing Low Income Superannuation Contribution will be replaced by a new Low Income Superannuation Tax Offset.

Although this has been announced as a new measure, it is essentially the same as the existing arrangement, where people with an adjusted taxable income of up to $37,000 pa will have tax paid on their concessional contributions refunded into their superannuation account, up to $500.

Removal of Anti Detriment Deduction for Superannuation Death Benefits

From 1 July 2017, the anti-detriment deduction provision will be removed.

Currently, an anti-detriment deduction is available if a superannuation fund increases the lump sum, or does not reduce the lump sum, so that the amount of the lump sum is the amount that the fund could have paid if assessable contributions had not been included in the assessable income of the fund.

To achieve this, the fund can deduct an amount to ensure that the amount of the lump sum death benefit is not reduced as a result of contributions being taxed.

Lump sum death benefits to dependants will remain tax free.

Defined Benefit Schemes (DBS)

Superannuation tax reforms will apply broadly to members of defined benefit schemes and constitutionally protected funds.

From 1 July 2017, members of these funds will be subject to the $250,000 threshold for high income contributions tax.

Also, to replicate the effect of the $1.6m transfer cap, pension payments over $100,000 pa from unfunded DBS and constitutionally protected funds will continue to be taxed at a person's marginal tax rate (MTR), with the 10% tax offset capped at $10,000 from 1 July 2017.

Fifty per cent of pension amounts over $100,000 pa from funded DBS will be taxed at a person's MTR.

Personal Tax Measures

Personal tax rates: no change; Budget deficit levy not to be extended.

The 32.5% personal income tax threshold will be increased from $80,000 to $87,000 in an attempt to address bracket creep, which is estimated to stop approximately 500,000 Australians from facing a Marginal Tax Rate of 37%.

Prior to the 2016 Budget, it was also indicated that the 2% Budget Deficit Levy for those earning over $180,000 pa would not be extended past the initial 3 years, and is due to cease at the end of the 2016/17 financial year (the fifth rate includes the budget deficit levy and will drop to 45% from 2017/18).

Personal income tax rates and thresholds

	2015-16		*2016-17*	
	Threshold	*Rate*	*Threshold*	*Rate*
1st rate	$0 - $18,200	0%	$0 - $18,200	0%
2nd rate	$18,201 - $37,000	19.0%	$18,201 - $37,000	19.0%
3rd rate	$37,001 - $80,000	32.5%	$37,001 - $87,000	32.5%
4th rate	$80,001 - $180,000	37.0%	$87,001 - $180,000	37.0%
5th rate	$180,001	47.0%	$180,001	47.0%

Medicare levy low-income thresholds for 2015-16

From the 2015-16 income year, the Medicare levy low-income threshold for singles will be increased to $21,335 (up from $20,896 for 2014-15). The individual phase-in limit is $26,668 for 2015-16 (up from $26,120).

For couples with no children, the family income threshold will be increased to $36,001 (up from $35,261 for 2014-15).

The additional amount of threshold for each dependent child or student will be increased to $3,306 (up from $3,238).

For single seniors and pensioners eligible for the SAPTO, the Medicare levy low-income threshold will be increased to $33,738 (up from $33,044 for 2014-15). The phase-in limit for taxpayers eligible for the SAPTO is $42,172 for 2015-16 (up from $41,305). The threshold for families eligible for SAPTO will be increased to $46,966 for 2015-16 (up from $46,000).

Date of effect: The increased thresholds will apply to the 2015-16 and later income years, as proposed in the Tax and Superannuation Laws Amendment (Medicare Levy and Medicare Levy Surcharge) Bill 2016, introduced in the House of Reps on 2 May 2016 and passed without amendment. It now moves to the Senate.

Medicare Levy Surcharge and Private Health Insurance Rebate - indexation pause to continue

The Government will continue the pause on indexation of the income thresholds for the Medicare Levy Surcharge and Private Health Insurance Rebate for a further 3 years from 1 July 2018.

Business Tax Measures

The Government has announced a *Ten Year Enterprise Tax Plan* that purports to boost new investment, create and support jobs and increase real wages, starting with tax cuts for small and medium-sized enterprises, that will permanently increase the size of the economy by just over one per cent in the long term.

The Government has also said it will continue its investment in the National Innovation and Science Agenda, including support for new start-up businesses.

In summary, and among a range of inclusions, the measures propose to support the Ten Year Enterprise Tax Plan through:

- Increasing the small business entity turnover threshold to $10 million from 1 July 2016;
- Increasing the unincorporated small business tax discount incrementally over 10 years from 5% to 16%;
- Reducing the company tax rate to 25% over 10 years;
- Targeting personal tax relief - increase the 32.5% tax threshold from $80,000 to $87,000 from 1 July 2016;
- Targeting amendments to Div 7A;
- Enhancing access to asset backed financing;
- Introducing a new tax and regulatory framework for two new types of collective investment vehicles (CIVs); and
- Reforming the TOFA (Taxation of Financial Arrangements) rules to reduce the scope, decrease compliance costs and increase certainty;

Small Business threshold to increase to $10m

The Budget announced that the small business entity threshold will increase from $2m to $10m from 1 July 2016.

As a result, a business with an aggregated annual turnover of less than $10m will be able to access a number of small business tax concessions from 1 July 2016, including:

- the simplified depreciation rules, including immediate tax deductibility for asset purchases costing less than $20,000 until 30 June 2017 and then less than $1,000;
- the simplified trading stock rules, which give businesses the option to avoid an end of year stocktake if the value of the stock has changed by less than $5,000;
- a simplified method of paying PAYG instalments calculated by the ATO, which removes the risk of under or over estimating PAYG instalments and the resulting penalties that may be applied;
- the option to account for GST on a cash basis and pay GST instalments as calculated by the ATO;
- immediate deductibility for various start-up costs (eg professional fees and government charges);
- a 12-month prepayment rule; and
- the more generous FBT exemption for work-related portable electronic devices (eg mobile phones, laptops and tablets)

  – the FBT car parking exemption for small business already applies to entities with "annual gross income" of less than $10m.

The Government estimates that between 90,000 and 100,000 businesses will benefit from this measure.

Interestingly, the threshold changes will not affect eligibility for the small business CGT concessions, which will only remain available for businesses with annual turnover of less than $2m or that satisfy the maximum net asset value test.

Multinational Enterprises: "Google tax" at 40% to be introduced

In the 2015 Budget announcement the then-Treasurer Joe Hockey announced enhancements to Part IVA and other legislative instruments to tackle multinational tax avoidance, aggressive tax planning, treaty shopping and base erosion and profit shifting (BEPS) in line with the OECD's 15-step action plan. He avoided introducing a UK-style diverted profits tax (DPT) but the Government has reversed that and instead announced that it will introduce a 40% diverted profits tax (DPT), (dubbed a "Google tax" when it was introduced in the UK in 2015).

There are however, significant differences from the UK's DPT. At the same time as the announcement, the Government released a consultation paper for comment about the DPT.

The new tax is aimed at multinational corporations that artificially divert profits from Australia. The tax is proposed to apply to income years commencing on or after 1 July 2017. The Government estimates this measure will have a gain to revenue of $200 million over the forward estimates period.

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

- that result in less than 80% tax being paid overseas than would otherwise have been paid in Australia;
- where it is reasonable to conclude that the arrangement is designed to secure a tax reduction; and
- that do not have sufficient economic substance.

Where such arrangements are entered into, the DPT will apply a 40% tax on diverted profits to ensure that large multinationals are paying sufficient tax in Australia.

Company tax rate to reduce to 25% by 2026-27

The Government intends to reduce the company tax rate to 25% over the next 11 income years.

The measure will be phased in, depending on the company's size (ie its aggregated annual turnover). Small businesses will benefit sooner. The phase-in for all companies will be completed in the 2026-27 income year.

The timetable is summarised in the table below.

Income year	Threshold (< $)	Rate (%)
2015-16 (current year)	2m	28.5
2016-17	10m	27.5
2017-18	25m	27.5
2018-19	50m	27.5
2019-20	100m	27.5
2020-21	250m	27.5
2021-22	500m	27.5
2022-23	1bn	27.5
2023-24	All companies	27.5
2024-25	All companies	27
2025-26	All companies	26
2026-27	All companies	25

Changes to Div 7A flagged

The Government will consult with stakeholders to make targeted amendments to improve the operation and administration of Div 7A. The changes are intended to provide clearer rules for taxpayers and assist in easing their compliance burden, while maintaining the overall integrity and policy intent of Div7A.

Subject to the outcomes of the consultation process, the Government will amend the Div 7A rules to include:

- a self-correction mechanism providing taxpayers whose arrangements have inadvertently triggered Div 7A with the opportunity to voluntarily correct their arrangements without penalty;
- new safe harbour rules, such as for use of assets, to provide certainty and simplify compliance for taxpayers;
- amended rules, with appropriate transitional arrangements, regarding complying Div 7A loans, including having a single compliant loan duration of 10 years and better aligning calculation of the minimum interest rate with commercial transactions; and
- technical amendments to improve the overall operation of Div 7A.

These changes draw on a number of recommendations from the Board of Taxation's Post-implementation Review into Div 7A (released on 4 June 2015

Collective investment vehicles – proposed new types

The Government will introduce a new tax and regulatory framework for 2 new types of collective investment vehicles (CIVs).

CIVs allow investors to pool their funds and have them managed by a professional funds manager.

A corporate CIV will be introduced for income years starting on or after 1 July 2017. This vehicle will allow Australian funds managers to offer investments through a company structure, which the Government said is well suited for offering retail investment products. A limited partnership CIV will be introduced for income years starting on or after 1 July 2018. The Government said this type of vehicle is commonly used overseas to facilitate wholesale investment by large investors, such as pension funds.

To implement this proposal, the Government will provide $2m to the ATO and $7.8m to ASIC, which will be partially offset by $0.7m in registration fees. The Government said the proposals will enhance the international competitiveness of the Australian managed funds industry and maximise the effectiveness of related Government initiatives aimed at increasing access to overseas markets, including the Asia Region Funds Passport.

The proposed new CIVs will be required to meet similar eligibility criteria as managed investment trusts, such as being widely held and engaging in primarily passive investment. Investors in these proposed new CIVs will generally be taxed as if they had invested directly.

GST small business taxpayers: election to use cash basis

The Government is proposing to extend the option for taxpayers to use the cash basis of accounting for GST. Currently there are 4 categories of eligible entities able to choose to use the cash basis:

1. an entity that satisfies the definition of "small business entity" for the purposes of the ITAA 1997, but not because of the "actual aggregated turnover test";
2. an entity not carrying on a business, provided its GST turnover does not exceed $2m;
3. an entity that for income tax purposes accounts for income using the receipts method; or
4. an entity that carries on an enterprise, or enterprises, of a kind specified by the

Commissioner as being approved for the cash basis.

The Government will extend the option to small businesses with an annual turnover of less than $10m. Such entities will be able to account for GST on a cash basis and pay GST instalments as calculated by the ATO.

Date of effect: The measure will apply from 1 July 2016.

BAS reporting for GST small businesses

The Government is proposing to simplify BAS reporting requirements involving GST for small businesses, ie entities with less than $10m turnover.

The Treasurer's press release states that the aim is that such entities "will be able to easily classify transactions, and prepare and lodge their BAS". Unfortunately, there are no details as to how this will be achieved.

The press release does state that a trial of the "new simpler reporting arrangements" will commence on 1 July 2016.

Date of effect: The measure will apply from 1 July 2017.

ATO guidelines on new tax laws

The ATO is to produce public guidelines on the meaning of new tax laws at the same time as they are being drafted. These guidelines will then be published as the legislation is introduced in Parliament.

Guidance would only be provided where legislation implements new initiatives or unfamiliar concepts, ie not where the concepts are straightforward (although is there any such thing in tax?). The guidelines will not have the same formal legal status as legislation, but are intended to provide certainty to taxpayers in how they can comply with new law. Nevertheless, the Fact Sheet states that one of the aims for publishing such guidelines is "to reduce the need for lengthy provisions in the tax law", so clearly the Government sees a close link between the proposed guidelines and the legislative drafting process.

Social Security Measures

Sustainable welfare – DSP eligibility to be reviewed

Budget is committed to a sustainable welfare system. Over the next 3 years, up to 90,000 current Disability Support Pension (DSP) recipients will have their DSP eligibility reviewed to assess their capacity to work. There will also be up to 30,000 Disability Medical Assessments for current DSP recipients considered to be a high risk of not being eligible for the payment.

Conclusion

There are significant changes to superannuation in this budget which, if implemented will change many wealth accumulation strategies. Keep in mind however that these are only proposals at present. There will not be another sitting of Parliament before the election on July 2. The likelihood of any of these measures being legislated will depend on the outcome of the election and the makeup of a potential post-double dissolution Senate. For more information on the tax and related announcements please contact your accountant or financial planner.

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