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TAX BRIEF

4 May 2015

Australia’s 2016-17 Budget

Introduction

Much of this year’s Budget was already ‘old news’ by the time the Treasurer stood to address Parliament at 7:30 last night. His speech confirmed many measures which had been selectively leaked to journalists: the small business measures, the Google tax Mk II, the increase to the top of the 32.5% income tax bracket, for example.

But a few well-placed rumours turned out not to be true: we did not see the threatened reduction to the 60:40 safe harbour for the thin capitalisation rules.

Of course, the Treasurer had kept a few surprises up his sleeve: the idea of a lifetime cap on non-concessional contributions to super funds was not foreshadowed.

And some measures we feared had been lost forever re-appeared such as the Board of Taxation’s work on consolidation and Islamic finance.

While all Budget announcements are to some extent mere declarations of intent, this year’s promises are more problematic than usual. Clearly, no government can meaningfully promise what the corporate tax rate will be in 2026. But even for measures with a more immediate start, it will be interesting to see how many matters can be enacted by the time Parliament is dissolved, expected later this week. The ALP has already let it be known that it will wait to see the detail before deciding whether to support particular Budget measures. And the Prime Minister would be brave to assume the support of all cross-bench Senators in the current environment.

Business tax measures

Reducing the company tax rate to 25%, eventually

The Government has announced a plan to reduce the corporate tax rate progressively. The goal is a corporate rate of 25%, but it will not be reached until 1 July 2026. Indeed, nothing will happen for large businesses until 2023-24 when the company tax rate will decline from 30% to 27.5%.

The rate will then reduce to 27% in the 2024-25 income year, and then decline progressively by 1 percentage point per year until it reaches 25% in the 2026-27 income year.

Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

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Changes to consolidation

Deductible liabilities. This measure significantly changes, and defers implementation of, proposed amendments to the consolidation tax cost setting rules in respect of liabilities held by an entity that joins a consolidated or MEC group where those liabilities will give rise to a deduction for the head company in the future (for example, employee leave provisions).

Under current law, future deductible liabilities are perceived to give rise to a double benefit because:

- 70% of the liability is taken into account in resetting the tax cost of the assets of the joining entity; and
- the head company is entitled to a deduction when the liability is later incurred or realised.

The Government previously announced proposed amendments to remove the double benefit in certain circumstances by bringing to account assessable income for the head company in respect of a joining entity's future deductible liabilities over a maximum of 4 years to, in effect, offset the deduction to which the head company would be entitled. Those amendments were consistent with recommendations in the Board of Taxation's April 2013 report and were proposed to take effect from 14 May 2013. However, the amendments could have applied where, in practice, no double benefit arose.

This measure does away with the proposed inclusion of amounts in assessable income and instead removes the perceived double benefit by removing the liabilities from the tax cost setting process when an entity joins a consolidated group. Importantly, the measure will now only take effect from 1 July 2016. This will be welcome relief for a number of taxpayers who potentially faced substantial amended assessments in respect of consolidation joining events that occurred on or after 14 May 2013.

Deferred tax liabilities. This announcement gives effect to another recommendation in the Board of Taxation's April 2013 report that deferred tax liabilities (**DTLs**) should be excluded from the consolidation tax cost setting process when an entity joins or leaves a consolidated or MEC group. This measure is intended to simplify the tax cost setting process and more closely align the tax and commercial outcomes. In particular, it will remove the need to consider how DTLs will be recorded by the consolidated or MEC group at the joining time and it will remove duplication that arises when an entity that has DTLs in respect of depreciating assets leaves a consolidated or MEC group.

This measure will take effect from the date the amending legislation is introduced into Parliament.

Securitised assets. This announcement extends to non-financial entities a previously announced amendment for financial entities. In particular, the Government announced in the 2014-15 Federal Budget that it would implement a recommendation in the Board of Taxation's April 2013 report to disregard accounting liabilities relating to securitised assets in certain circumstances when an entity joins or leaves a consolidated or MEC group. The recommendation related to the interaction of the accounting rules and the tax consolidation regime for securitised asset vehicles because anomalous outcomes could arise where an accounting asset and liability are recognised in the securitisation vehicle but only the liability is taken into account under the consolidation tax cost setting rules. Exposure Draft legislation to effect the recommendation was released on 28 April 2015 and it was proposed for the change to take effect broadly from 13 May 2014.

This measure will extend to securitisation arrangements involving all entities, rather than being limited to securitisation arrangements involving financial institutions, where the arrangement commences on or after 3 May 2016.

Reform of the Taxation of Financial Arrangements (TOFA) regime

It has taken a while, but the Government has finally acknowledged that the general TOFA regime and the foreign exchange rules, are considerably over-engineered.

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The Budget announced that the TOFA rules will be reformed (again). The idea is to reduce their scope, decrease compliance costs and increase certainty. The new rules will apply for income years starting on or after 1 January 2018.

There will be four key components to the reforms:

- a 'closer link' to financial accounting rules for taxpayers wishing to make the book/tax election. This is something the banking industry has been seeking for only about 25 years, i.e. ever since the original TOFA reform process started;
- simplified accruals and realisation rules for taxpayers who do not make the financial reports adoption election;
- a new tax-hedging regime which is easier to access. Amongst other things, the revised regime will encompass more types of risk management arrangements, including risk management of a portfolio of assets; and
- simplified rules for the taxation of foreign exchange gains and losses. The law in this area has been unsatisfactory for many decades – even before the enactment of the first failed legislative regime in 1986, i.e. the former Division 3B.

The Budget also indicated that previously announced but un-enacted TOFA measures, some going back to 2004, will be addressed in this latest reform process. This includes the welcome extension of the range of entities that can use a non-AUD functional currency for tax purposes.

Greenwoods Directors, Tony Frost and Andy Hirst, have been part of a small group of Treasury, ATO and private sector representatives who worked up the announced measures over the last year or so.

'Asset-backed financing'

The Government will amend the tax law 'to remove key barriers to the use of asset backed financing arrangements, which are supported by assets, such as deferred payment arrangements and hire purchase arrangements'. The amendments will clarify the tax treatment of such arrangements 'and ensure that they are treated in the same way as arrangements based on interest bearing loans or investments'.

Although not made clear in the announcement, we understand that this a reference to Islamic financing and other similar transactions where no 'interest' is payable.

A Discussion Paper on Islamic finance was released by the Board of Taxation in October 2010. The Board's subsequent Report in June 2011 was never publicly released, but we understand will now be released on 4 May 2016.

The premise of the Discussion Paper was that these arrangements should be taxed on the basis of their economic substance rather than legal form. However, it is not clear whether the current proposal is to simply amend the existing financing arrangement rules in the tax law (for instance, TOFA, Division 240 etc.) or instead to introduce new specific rules for asset backed financing, and if so whether those rules would be principles-based or target just specific types of arrangements.

The new measures are proposed to apply from 1 July 2018.

Implementing a new suite of collective investment vehicles

In May 2010, the then Government announced its intention to review the tax treatment of collective investment vehicles (**CIVs**), potentially to extend the range of vehicles whose investors could enjoy flow-through tax treatment. In June 2015 the Government released the report on CIVs prepared by the Board of Taxation.

The Government has now announced that it will introduce a new tax and regulatory framework for two new types of entities, being:

- a corporate CIV – to apply for income years from 1 July 2017; and
- a limited partnership CIV – to apply for income years from 1 July 2018.

The reforms are aimed at enhancing the international competitiveness of the Australian managed funds industry by allowing fund managers to offer investment products using CIV entities that are commonly used overseas.

However, enacting a pure flow-through regime for resident companies and limited partnerships will require significant adjustments to our existing tax rules to deal with issues such as character retention, source retention, timing and deferral, no pass-through of losses and so on. But the tax issues are likely to pale into insignificance when compared to the changes that will be needed to the regulatory environment, at both the national and State levels.

The announcement is short on detail other than stating that new CIVs will have to meet eligibility criteria similar to those imposed on managed investment trusts, such as being widely held and being involved primarily in passive investment activities.

Diverted profits tax

The centrepiece of the Government's crackdown on multinational tax avoidance is a proposed diverted profits tax (**DPT**), which adopts the main features of the second limb of the UK's DPT. The expressed purpose of the DPT is to 'help ensure that large multinational corporations pay an appropriate amount of tax on profits made in Australia'.

Unlike last year's multinational tax avoidance centrepiece, the multinational anti-avoidance law (**MAAL**), the DPT is not confined to foreign multinationals. It is deliberately designed to apply to Australian based multinationals as well.

No draft legislation has been released. Instead, the bulk of the currently available detail on the DPT is found in the Treasury Discussion Paper released as part of the Budget. The closing date for submissions on the Discussion Paper is 17 June 2016. At this stage, it is unclear whether the DPT will be housed in Part IVA or indeed within the income tax acts at all.

Importantly, the DPT is to apply to income years commencing on or after 1 July 2017. This choice of income year-based commencement is deliberate: it means that existing arrangements are not grandfathered from the DPT. Moreover, the ATO has an extended period – 7 years from tax return lodgement – to commence the DPT assessment process.

Overview. In summary, the DPT will:

- impose a penal tax rate of 40% on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid on profits generated in Australia by more than 20%;
- apply where it is reasonable to conclude based on the information available to the ATO at the time that the arrangement is designed to reduce Australian tax liability;
- impose a liability when the ATO issues an assessment;
- require that any DPT liability be paid up front;
- only allow the taxpayer to object or appeal at a much later stage; and
- put the onus on taxpayers to provide relevant and timely information on offshore related party transactions to the ATO to prove why the DPT should not apply.

Application. The Discussion Paper sets out the main requirements but some important issues are yet to be addressed:

Requirement #1: the taxpayer is either an Australian tax resident or an Australian permanent establishment of a foreign resident.

Requirement #2: the taxpayer is a member of a group which has annual consolidated turnover of at least A$1 billion. This appears to correspond to the 'significant global entity' definition that accompanied MAAL and focusses on the relevant accounting group.

Requirement #3: the *de minimis* threshold does not apply. That is, the DPT will not apply where there is less than A$25m Australian annual turnover on an aggregated related party basis – unless the Australian income has been artificially booked offshore.

Requirement #4: the taxpayer has a 'dealing' with a related party outside Australia.

Requirement #5: the taxpayer's (increased) foreign tax liability is less than 80% of the (reduced) Australian income tax liability as a result of the dealing. This is referred to as the effective tax mismatch requirement. There are some intricacies in how the foreign tax liability is computed for these purposes. For example:

- the reason for the foreign tax liability being lower than the Australian tax liability is not relevant (e.g. lower tax rates or, tax relief);
- the quantum of foreign tax excludes taxes other than income taxes (e.g. goods and services taxes); and
- interestingly, as is the case in the UK, the quantum of foreign tax will be computed on the hypothetical basis that any losses actually applied were not available. That is, an effective tax mismatch will not arise only because of the availability of foreign losses.

Requirement #6: based on the information available to the ATO, it is reasonable to conclude that the arrangement was 'designed' to secure a reduced Australian tax liability.

The Discussion Paper has little to say about this critical requirement. It raises many issues, including the following:

- will this requirement automatically be satisfied unless the taxpayer provides sufficient corroborative information to the ATO?
- it appears that the UK safe harbour approach will be adopted: that is, this requirement will be taken not to be satisfied where the 'quantifiable (non-tax) commercial benefits' of the arrangement exceed the amount of the effective tax mismatch. Quantifying these benefits would often be expected to result in a divergence of opinion;
- but presumably the opposite is not true: this requirement will not be taken to be satisfied where the amount of the effective tax mismatch exceeds the quantifiable (non-tax) commercial benefits of the arrangement;
- in those circumstances, it is necessary to understand what the 'designed' requirement involves. It appears to involve a purpose based test – yet rather than leveraging off the familiar Part IVA purpose concepts, it introduces an entirely new inquiry. (Keen students of MAAL will recall that the 'designed' requirement was in the Exposure Draft legislation, but was subsequently discarded. They will also recall that the accompanying Explanatory Memorandum was of little assistance in understanding this requirement …);
- at this stage, there is no direction to have regard to the 8 familiar factors listed in Part IVA to ascertain an actor's purpose;

- at this stage, there is no equivalent of a dominant purpose threshold – or even a principal purpose threshold – and so it will be difficult to apply this requirement where multiple purposes (or 'designs') are involved;
- interestingly, the ATO 'will have a broad discretion to not apply the DPT where the Commissioner considers the transaction or arrangement to be low risk'; and
- unlike the UK, related party loans are not excluded from the DPT. However, the 'diverted profits amount' will only take into account the pricing of debt – not the amount of debt – provided the amount of debt is within the thin cap safe harbour debt amount (as opposed, it seems, to the other methods of satisfying the thin cap provisions).

Assessment amount. The assessment amount is the product of two things: the 'diverted profits amount' (see below) and the DPT rate, which will be 40%.

The 'diverted profits amount' will ordinarily be the best estimate of the 'diverted taxable profit' that can reasonably be made by the ATO at the time. There is little guidance on this critical issue. An Appendix to the Discussion Paper indicates that this involves a reconstruction of events – that is, a comparison with the tax payable under alternative scenarios. That Appendix asserts that the alternative to a lease by an Australian entity to an equity funded foreign related party is the Australian entity being equity funded and acquiring the asset directly (and not making any lease payments). It is hard to see how this result follows from the body of the Discussion Paper.

Where the deduction claimed is considered to exceed an arm's length amount ('inflated expenditure' cases), the provisional Diverted Profits Amount will be 30 per cent of the transaction expense. However, the Discussion Paper indicates that the DPT assessed amount will be reduced to reflect only the DPT rate applied to the excess over the arm's length amount.

In either case, the DPT assessed amount will be net of Australian CFC income and withholding taxes payable in respect of the arrangement. Importantly, the DPT assessed amount will not be net of foreign taxes. Interest may also be payable. But the potential application of penalties is currently unclear.

Assessment process. The assessment process is draconian:

- unlike a Part IVA determination and consequent amended assessment, the DPT process starts with the ATO issuing a 'provisional' assessment and detailed reasons why the DPT applies;
- there is then a 60 day taxpayer representation period;
- the 'final' DPT assessment then issues within 30 days;
- importantly, the DPT assessed amount is payable within 21 days, with no right of appeal at this stage (but see below);
- there is then an ATO review of the DPT assessment within 12 months of the final DPT assessment – at which point the DPT assessed amount may be increased or decreased; and
- the taxpayer only has a right to appeal within 30 days of the end of the ATO review period.

Changes to transfer pricing rules

In February 2016, Treasury released a Discussion Paper on how to address the problem that our domestic transfer pricing rules are currently linked to the OECD's Transfer Pricing Guidelines as they stood when 'last amended on 22 July 2010'.

The BEPS project will make significant changes to those Guidelines. BEPS Action Items 8-10 in particular, will lead to changes to the text dealing with intangibles, the contractual allocation of risks and re-characterisation. The Final Report on BEPS Action items 8-10, released in October 2015, proposed significant changes to the OECD Guidelines and more changes are expected in 2016 and 2017.

The announcement in the Budget says that Australia's transfer pricing rules will be amended 'to give effect to the 2015 recommendations'. The changes will apply from 1 July 2016.

There are at least 2 problematic aspects of this announcement. First, the 2015 Final Report is not yet formally incorporated into the Transfer Pricing Guidelines and it is not clear that the OECD will be publishing an updated version of the Guidelines soon. Taxpayers will probably have to assemble their own 'cut-and-paste' version of the Guidelines for some time. Secondly, this announcement suggests we are not going to abandon the practice of hard-wiring our law to a static version of a document that is constantly moving.

Anti-hybrid mismatch rules

One of the cornerstones of the BEPS project has been Action Item 2 in relation to *Neutralising the Effects of Hybrid Mismatch Arrangements*.

Although the detail behind this measure is extremely complex (the OECD 2015 Final Report runs to 450 pages), the basic principle is straightforward, in that it seeks to prevent asymmetrical tax treatments in relation to cross border 'hybrid' arrangements. The classic example is an instrument that is treated as debt in Country A (with returns being deductible to the payer) but equity in Country B (with returns being exempt for the recipient).

The OECD Report was issued in October 2015 and the Board of Tax consulted with industry (in late 2015/early 2016) before providing its report to Government in March 2016. The Government has released the Board's report and announced that it will implement the OECD's principles taking into account the recommendations of the Board.

Although the Government had signalled that it wanted to implement the OECD's recommendations on hybrids, the Board's Report does not simply accept all the reasoning and recommendations in the OECD Report. Further, the Board acknowledges some of the potential difficulties with being an 'early adopter' – e.g. creating a further hurdle to investment in Australia, increasing the cost of capital and potentially putting Australian businesses at a competitive disadvantage. Although the Board acknowledges these issues, the Board recommends the adoption of a number of the OECD's principles.

In high-level terms, the key recommendations of the Board are:

- the implementation of a rule that denies an Australian taxpayer an exemption for its receipt of a 'dividend' (i.e. the exemption for non-portfolio returns on equity interests that now exists in Subdivision 768-A, previously s.23AJ) where the non-resident payer of the 'dividend' gets a deduction for the payment in its home jurisdiction;

- the implementation of a rule that denies an Australian taxpayer a deduction for the payment of a return on an instrument where the foreign recipient of the return is not assessable on the return in the foreign jurisdiction (typically because of the availability of a dividend exemption in the foreign jurisdiction);

- further consultation be undertaken on whether and how any such rules should apply to regulatory capital issued by banks and insurance companies - i.e. the Board recognised the complexities of these instruments and did not want to make a recommendation without considering the issues in further detail. The Treasurer has recognised this and has asked the Board to undertake a further review to examine how best to implement rules to eliminate hybrid mismatch arrangements that arise in relation to regulatory capital (this further report is to be provided to the Treasurer by the end of July 2016). The Treasurer has specifically asked the Board to examine how best to implement the OECD recommendations 'to eliminate deductible/frankable hybrid mismatch arrangements';

- the implementation of the new rules from the later of 1 January 2018 or six months following the date of Royal Assent to the enabling legislation – this is important as taxpayers will need time to restructure arrangements; and
- subject to one or two potential exceptions (in relation to third party arrangements where there is a significant detriment to investors and changes affecting regulatory capital issuances of banks/insurance companies) there should not be any grandfathering of existing arrangements.

The Board has not recommended implementing a number of principles set out in the OECD Report – the prime reason being that, in various areas, the Board was unconvinced that the changes were required in order to protect integrity concerns in Australia.

There is still a long way to go as we await the further review by the Board in relation to regulatory capital issuances of banks and insurance companies. At some stage in 2016 or 2017, we will see draft legislation. As always, further complexities will arise in this process.

Tax incentives for innovation

The Budget has referred to two of the announcements from the Government's National Innovation and Science Agenda of December last year:

- an incentive for investments in early stage innovation companies (**ESICs**), in particular:
  - a 20% carry forward non-refundable tax offset on investments in ESICs capped at $200,000 per year per investor;
  - an exemption on capital gains made on shares held for between 12 months and 10 years in ESICs; and
  - if the shares are held for more than 10 years, any gain will be deemed to be on capital account and the investor will get a deemed market value on the 10 year anniversary; and
- a 10% non-refundable tax offset for investors in early stage venture capital limited partnerships (**ESVCLPs**), together with a number of improvements to the ESVCLP and venture capital limited partnership (**VCLP**) regime generally. One of the key improvements will be that eligible investments for a VCLP/ESVCLP should include start-ups involved in fintech in insurance and finance related activities (see our Riposte for further information).

These measures are currently before the Senate after being passed by the House on Monday. Given the 1 July 2016 start-date, it is hoped that these measures are enacted before Parliament is dissolved possibly later this week.

Related changes to the same business test for the recovery of company losses and the depreciation of intangibles are currently the subject of consultation.

Small company tax rate

From 1 July 2016, the company tax rate will be reduced from 28.5% to 27.5% for small businesses with an aggregated annual turnover below $10 million.

This 27.5% tax rate will then be gradually made available to more companies over the next 7 years, and the rate will decline thereafter until it reaches 25%. The table below summarises this tortuous path to a 25% rate:

Income Year	Annual Aggregated Turnover Threshold	Tax Rate
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	none	27%
2024-25	none	26%
2025-26	none	25%

Increase to the small business entity turnover threshold

The Government will increase the small business entity turnover threshold from $2m to $10m from 1 July 2016. This threshold is relevant for concessions such as:

- the small business corporate tax rate;
- the immediate deduction of assets costing less than $20,000; and
- accelerated depreciation through the small business pooling provisions.

The current $2m turnover threshold will be retained for access to the small business CGT concessions – apparently the Government couldn't afford to lift this threshold.

Increases to the unincorporated small business tax discount

In last year's Budget the Government introduced a tax offset for those operating through an unincorporated small business entity recognising that many small businesses would derive no benefit from a reduction in the corporate tax rate. In broad terms, the offset is currently 5% of the tax that would otherwise be payable on each individual's share of taxable income attributable to a small business entity. The tax offset is capped at $1,000 per individual.

In this year's Budget, the Government has announced that the measure will be extended:

- the measure will be extended to small business entities with a turnover of less than $5m – currently $2m;
- the discount will be increased from 5% to 8% from 1 July 2016; and
- the discount will increase to 10% in 2024-25, 13% in 2025-26 and 16% from 2026-27.

While the available discount percentage will increase over time, the cap of $1,000 remains static, meaning that few taxpayers may actually enjoy the full 16% discount.

Amendments to Division 7A

The Government is proposing to make targeted amendments to improve the operation and administration of Division 7A which deals with private company dividends. While the proposed changes are mainly compliance focused, they draw on a number of recommendations raised in the Board of Taxation's *Post-Implementation Review into Division 7A* released in 2015 and include:

- providing taxpayers with a self-correction mechanism to correct any arrangements which 'inadvertently' trigger the application of Division 7A without attracting a penalty;
- the introduction of new safe harbour rules aimed at preventing the application of Division 7A in certain circumstances where an asset is provided for use by a company to a shareholder or associate;
- amendments to the documentation requirements for compliant Division 7A loans; and
- technical amendments to improve the overall operation of Division 7A. The detail or extent of these technical amendments is yet to be provided.

It is expected that Treasury will consult on the amendments and any changes are expected to apply from 1 July 2018.

Personal tax

Changes to personal income tax rates and increasing the Medicare levy low-income thresholds

As expected, the Government announced that the top of the 32.5% income tax bracket will increase for the 2016-17 income year from $80,000 to $87,000. The Government expects that this measure will ensure that average full-time wage earners will now not move into the next tax bracket (37%) until 2019-20.

The Budget Papers also note that the low-income threshold for the Medicare levy will increase in line with movements in CPI for the 2015-16 year and later years. The Bill to enact this measure was just passed by the Senate.

The superannuation package

Numerous superannuation tax changes will apply from 1 July 2017 in the most fundamental reform of Australia's superannuation system in a decade.

Objective of superannuation tax concessions. The Treasurer confirmed that the objective of superannuation is to provide income in retirement to substitute or supplement the Age Pension. The objective will be enshrined into a separate law.

In line with the objective, the changes focus on targeting the tax concessions on encouraging individuals who need to save more in order to reduce Government Age Pension reliance. A number of the changes will be positive for life insurance companies. Approximately 4% of higher income and higher wealth superannuation fund members are identified as losers.

By the last year of the forward estimates in 2019-20 the changes will be taking an extra $1.5 billion net tax from superannuation compared to the status quo.

Concessional contributions - abolition of the work test to claim tax deductions for contributions. Any individuals up to age 75 will be able to make tax deductible concessional contributions. Currently only employers and individuals who earn less than 10% of their income and reportable benefits from employment can claim tax deductions.

The change dispenses with the complexity of the 10% rule, allows direct contributions by employees denied salary sacrificing opportunities by their employer, and should allow simplification of existing salary sacrifice arrangements.

Concessional contributions – $25,000 concessional contributions cap. The concessional contributions cap will be lowered to $25,000 irrespective of age (down from $30,000 if aged under 50 and down from $35,000 if aged 50 or over). Individuals with less than $500,000 of superannuation savings will be able to carry forward the unused portion of the cap in 2017/8 and subsequent years on a rolling 5-year basis. This will assist individuals with broken work patterns.

Concessional contributions – variable tax rate on concessional contributions. The superannuation fund pays 15% tax on concessional contributions. Higher income individuals earning over $300,000 pay an additional 15% tax on the contributions under Division 293. That threshold will be reduced to $250,000. The combined tax will still be lower than their marginal rate.

The current 15% Low Income Superannuation Contribution of up to $500 that largely eliminates tax on mandatory employer concessional contributions for individuals with adjusted taxable income up to $37,000 will be replaced with a tax offset in the fund.

Non-concessional contributions. A $500,000 lifetime non-concessional contributions cap will apply. The cap will be indexed with AWOTE. All non-concessional contributions since 1 July 2007 will count towards the cap. Excesses will need to be withdrawn, or a penalty tax will apply. However, excess non-concessional contributions made before 7:30pm on 3 May 2016 are not subject to either of these rules.

Spouse contributions. The income threshold for the low income spouse offset of up to $540 will increase from $10,800 to $37,000. Qualifying spouse contributions attract an 18% tax offset of up to $540.

Work test rules. Contribution conditions and rules for individuals aged 65 to 74 will be aligned with those for individuals younger than 65. That means they will be able to make additional contributions without needing to meet the work test and receive contributions from their spouse.

Retirement phase – $1.6m cap on transfers to retirement phase. Individuals will only be allowed to transfer $1.6m of accumulated superannuation into retirement phase, plus the earnings thereon. These changes limit the amount of superannuation savings that high wealth individuals can apply the earning tax exemption to.

Existing excess balances will need to be reduced back to $1.6m by 1 July 2017, eg by transfer back to accumulation phase where 15% tax applies to earnings.

Retirement phase – deferred annuity products etc. The earnings tax exemption currently available for superannuation pensions will be extended to products including deferred lifetime annuities and group self-annuitisation. The Government is hoping to see growth in such products.

A different tax break of roughly equivalent value already exists for whole of life policies within accumulation phase. We may also see those products re-enter the Australian market given the proposed $1.6m limit on retirement phase assets.

Retirement phase – ability to draw pensions instead as lump sums will be removed. The rule that allows pension payments to instead be taxed as lump sums will be removed. This change prevents the first $195,000 drawn between preservation age and age 59 being tax free to the member as a lump sum while at the same time enjoying the earnings tax exemption in the fund.

Retirement phase – transition to retirement pensions. Transition to retirement pensions will be considered an accumulation phase product subject to 15% earnings tax in the fund. This change may increase incentives for some individuals to retire from their job before age 65, and simply draw a retirement pension instead. Even without retiring, transition to retirement pensions will often still provide an advantage from age 60, and possibly even from preservation age.

Death benefits – anti-detriment abolition. The anti-detriment tax deduction in the fund that effectively recompenses the 15% contributions tax paid on amounts supporting death benefits provided to a spouse or child (including an adult child) will be abolished. The deduction had allowed death benefits to these people to be uplifted by up to about 17%. The abolition will increase the cost of adequate insurance coverage for ordinary members.

The 15% de facto death duty on the taxable component of death benefits paid to a non-dependant remains.

Defined benefit funds. Changes that have broadly similar effect will be made for defined benefit funds. Specific points to note are:

- not all funds will be required to accept personal deductible contributions. These are the untaxed funds, Commonwealth defined benefit funds and any State, Territory or corporate defined benefit scheme that chooses;
- notional (estimated) contributions will count towards the concessional contributions cap for members of unfunded defined benefit schemes and constitutionally protected funds;
- after-tax contributions into defined benefit funds and constitutionally protected funds will count towards the $500,000 life time limit on non-concessional contributions; and
- the $1.6m limit on retirement phase savings that attract earning tax exemption will be achieved for defined benefits through tax changes for defined benefit pensions over $100,000.

Indirect taxes

Applying GST to low value imported goods

The Government has finally, officially announced that it will impose GST on ‘low value’ goods imported by Australian consumers from 1 July 2017. The (then) Treasurer announced on 21 August 2015 that the State Treasurers had unanimously agreed to this in principle.

Under a proposed ‘vendor registration’ model, the onus will be placed on non-resident suppliers to register for GST where their Australian turnover is $75,000 or more and to collect and remit GST on ‘low value’ goods supplied to Australian consumers. No draft legislation was released on Budget night, so the finer details of how the rules will apply to non-residents and administrative burden it will impose on them is yet to be seen.

It is estimated that by 2019-20, this measure will raise $130m of GST revenue per annum. However, the measure will require $13.8m of funding to the ATO over the next four years. Once implemented, the Government will review the arrangements every two years, to ensure they are in line with the intended outcomes and with international developments in this area.

The debate around applying GST to all imports in an effort to ‘level the playing field’ between Australian and overseas suppliers has been a popular area of discussion over the past few years. This announcement provides more detail about how the Government intends to achieve this, but it will be interesting to see how the proposed legislative changes will be made and enforced.

Treasury Discussion Paper on digital currencies

On Budget night, Treasury also released a discussion paper on the GST treatment of digital currency launching the public consultation process on how to implement the Government policy announced on 21 March 2016 to ‘address the double GST treatment of digital currencies’.

The Discussion Paper outlines, and gives examples of, the issue with the current GST treatment of digital currencies – such as Bitcoin – as a form of intangible property that is neither 'money' nor an input taxed supply. That characterisation means that the supply of the digital currency to the consumer is taxed and the supply to the consumer paid for with the digital currency may also be taxed – effective double taxation.

This GST 'double taxation' treatment, outlined in the Commissioner's ruling, was recommended to be changed by both the Senate Economics References Committee (4 August 2015) and the Productivity Commission (7 December 2015). And so it shall be, but how? The Treasury Discussion Paper raises the two main issues to resolve in making the change:

- how should 'digital currencies' be identified – a stand-alone definition or a list determined by the Treasurer or Commissioner? (apparently there are over 600 types of digital currencies and the Government does not want to include loyalty points, videogame 'currency' or synthetic derivatives in the changes); and
- what should the treatment be – expand the definition of 'money' or make supplies of digital currencies 'input taxed'?

There are potentially other issues that will arise – such as the valuation and timing issues involved in converting GST liabilities for supplies paid for by digital currency. Also, other tax implications (including CGT and FBT), while expressly not part of this policy announcement, will need to be considered in the process.

GST concessions for small businesses

There were two GST-related small business tax concessions announced by the Assistant Treasurer. These concessions are aimed at simplifying the GST process for small businesses with a turnover of less than $10m, by providing them with:

- the option to account for GST on a cash basis (previously only available to businesses with turnover of less than $2m) and to pay GST instalments calculated by the ATO – applicable from 1 July 2016; and
- a simplified BAS reporting process available from 1 July 2017 apparently involving simplifying the classifications of transactions, preparation and lodgement of BASs. Trials of the new simplified reporting arrangements are to begin from 1 July 2016.

Revival of the Netflix Tax and cross-border changes

Although it did not receive a specific mention in the Budget, the Bill containing the 'Netflix Tax' (originally announced in the 2015 Budget) and subsequent cross-border changes (Tax and Superannuation Laws Amendment (2016 Measures No. 1) Bill 2016) was revived on 2 May 2015, after lapsing when Parliament was recently prorogued. The Senate agreed to resume the consideration of this Bill, but there must be some doubt whether this Bill will be finalised before the Parliament is dissolved.

Tobacco excise

Four annual 12.5% increases in tobacco excise and excise equivalent customs duties will be implemented, with the first to take effect on 1 September 2017. These will replicate annual increases that have been in place for the past four years, and are in addition to existing indexation.

In addition, from 1 July 2017, the duty free tobacco allowance will be limited to 25 cigarettes or equivalent from the current 50 cigarette allowance.

These changes are made in conjunction with strengthening the enforcement response and existing penalties imposed for illicit tobacco offenses.

Tax administration

The Tax Avoidance Taskforce

In line with the Budget's focus on tax avoidance, the Government has announced the establishment of a new taskforce (to be known as the Tax Avoidance Taskforce) within the ATO, which will undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals, specifically including those recently exposed by the Panama papers.

The announcement of this Taskforce follows in the footsteps of current and past compliance programs, including the International Structuring and Profit-Shifting initiative, Project Wickenby and the creation of the Serious Financial Crime Taskforce announced in last year's Budget.

The establishment of the Taskforce is intended to increase Australia's capacity to identify tax avoidance and to work with other countries to combat tax evasion and tax avoidance. It will draw together the ATO's current work addressing the tax affairs of such persons into a single targeted program and is seen by the Government as having a critical role to play in delivering on the OECD/G20 BEPS recommendations released in October 2015.

Interestingly, in a new development for the tax disputes resolutions process, a panel of former judges will be established to support the Taskforce by reviewing any proposed settlement arrangements with the ATO to ensure that they are 'fair and reasonable'.

The Government has also signalled that, as part of the role of the Taskforce, the ATO will be testing the law through Court cases where there is deliberate tax avoidance.

New laws will be introduced to improve the ATO's information sharing and analysis with ASIC to support the operation of the Taskforce through improved risk analysis and detection. The Taskforce will also work with the Australian Crime Commission, the AFP and AUSTRAC.

The Taskforce, a team of over 1,000 people to be led directly by the Commissioner of Taxation, will be provided with $679 million of funding over four years and, it is claimed, will raise more than $3.7 billion in tax over the forward estimates.

Increasing administrative penalties for significant global entities

The Government has announced that the administrative penalties for failing to lodge tax documents with the ATO on time will be increased for 'significant global entities' by a factor of 100, from $4,500 to $450,000, and the penalties relating to making false statements to the ATO will be doubled.

These changes appear to be a response to the private member Bill introduced into Parliament by Andrew Leigh. His Bill sought to increase penalties for companies with revenue of $1bn or more that failed to lodge country-by-country reports with the ATO by a factor of 50. But this measure appears to go further than that Bill, by applying these penalties to all statements required to be lodged by such companies, rather than just country-by-country reports.

The term 'significant global entity' is defined in the Act to include members of global groups with consolidated income of $1bn or more. Presumably this measure will also extend to such entities, although there is some ambiguity as the announcements refer only to companies which themselves have global revenue of $1bn or more.

Voluntary code for the disclosure of tax information

As part of the Budget, the Government has released the Board of Taxation's final report on the introduction of '*A Tax Transparency Code*.' The Board was asked to undertake consultation on this measure in July 2015, releasing a Consultation Paper in December 2015, and submitting its report to the Government in February.

At present, the ATO is required to disclose the total income, taxable income and income tax payable of listed companies with total annual income of $100m or more, and private companies with taxable income of $200m or more. The first of these reports was released (and provoked much interest and discussion) in December 2015.

Some taxpayers, in an effort to appear to be on the 'front-foot', have voluntarily disclosed greater tax information in their recent financial reports. We have previously summarised what Australian and overseas corporates have disclosed in their tax reports in a Riposte.

Tonight's announcement is not especially definitive: the Government has not declared it will adopt the Board's version of the Tax Transparency Code but the Treasurer does say the Government is 'committed to encouraging greater tax transparency within the corporate sector, especially by multinationals.' Accordingly, it is likely the Government will adopt the Board's recommendations, and probably in full.

The following is a brief summary of what the Code would require, based on the report released tonight.

Who is expected to implement to the TTC? The TTC should only apply to companies and entities taxed like companies. The Board recommends the TTC should apply to businesses with:

- a 'TTC Australian turnover' of $500m or more (being 'large businesses'); and
- a 'TTC Australian turnover' between $100-$500m (being 'medium businesses').

Importantly, while the TTC may well be aimed at 'multinationals', the Board considers the TTC should apply to both Australian-headquartered, and foreign-owned companies.

Further, the Board notes that due to their tax transparent nature, trusts are not to be brought within the TTC. Some readers may recall the issues some stapled groups had in respect of the disclosure of their low effective tax rates due to the trust-side of their group not paying tax in its own right. No doubt, the Board's recognition of that fact is welcomed by those groups.

What are affected taxpayers expected to disclose? The Board recommends that, at a minimum, both 'medium' and 'large' businesses should disclose:

- a reconciliation of accounting profit to income tax expense, and from income tax expense to income tax paid or income tax payable, and in so doing identify material temporary or non-temporary differences;
- an Australian accounting effective tax rate (**ETR**) calculated as company income tax expense divided by accounting profit; and
- a global ETR (if applicable) calculated for the worldwide accounting consolidated group of which the Australian operations form a part.

There has been much conjecture over how a company's ETR should be calculated for these purposes. In this regard, the Board recommends the Australian Accounting Standards Board develop guidance material, including establishing a common definition of ETR.

In addition to the above, the Board recommends 'large businesses' disclose information on:

- tax policy, tax strategy and governance, including:
  - approach to risk management and governance arrangements;
  - attitude towards tax planning;
  - accepted level of risk in relation to taxation; and
  - approach to engagement with the ATO; and
- the businesses' total Australian tax contribution (i.e. all taxes, not just income tax); and

- international related party dealings.

How should affected taxpayers disclose this information? The Board does not prescribe a template or form for reporting, nor the time by which such reports should be disclosed. Rather, in broad terms, the Board recommends that companies consider disclosing all of the above in a separate 'taxes paid' report or in improved tax disclosures in financial reports.

The Board does not consider that these separate disclosures need to be audited, as much of the information is derived from audited financial statements in any event. Obviously, reputational issues should ensure that any information disclosed by companies is not misleading.

When are affected taxpayers expected to adopt the TTC? The Government encourages all affected taxpayers to adopt the TTC from the 2016 financial year onwards. Obviously, for those that have not reported already, there is not a great deal of time should such companies wish to adopt the TTC for the upcoming reporting season.

Disclosure of potential tax avoidance schemes

The Government has announced that it will consult on new rules requiring tax and financial advisors to report potentially aggressive tax planning schemes.

Whilst it is not explicit in the announcement, this measure appears to draw on the recommendations for mandatory disclosure rules contained in the final report of the OECD on BEPS Action Item 12. The Mandatory Disclosure Rules recommend the reporting of transactions or arrangements to the relevant tax authority that bear certain hallmarks, including where a fee is paid to a promoter or where there is a particular area of concern such as the utilisation of tax losses. Rules like this already exist in the UK, US and Canada and the BEPS recommendations were clearly framed with those regimes in mind.

A disclosure regime of this type is already in place in Australia for certain large corporate groups that are required to make certain additional disclosures to the ATO each year, reporting positions that are not at least reasonably arguable (known as Reportable Tax Positions). The Budget announcement proposes that the disclosure requirements be extended to tax and financial advisors with the relevant disclosure thresholds to be determined through consultation.

Tax whistleblowers

The Government has announced it will introduce 'whistleblower' protection for people including employees, former employees and advisors who come forward to provide information to the ATO on what is rather broadly described as 'tax avoidance behaviour and other tax issues' and 'tax misconduct.'

The protection provided to whistleblowers will include identity protection, as well as protection from victimisation and civil and criminal action. Presumably this will have to extend to protection from actions by clients, employers and maybe even third parties to be effective.

This measure will take effect from 1 July 2018.

Just what has prompted this announcement is not clear; it does not come out of the BEPS Action Plan, nor is it a matter that has emerged from the current Senate inquiry into Corporate Tax Avoidance. Andrew Wilkie did introduce a private member Bill on whistleblower protection in 2012 but his Bill was mainly focussed on revealing foreign bribery. The Tax Justice Network noted the potential to extend this Bill to reporting tax crime, but the Budget announcement has come as a surprise.

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Reducing administrative complexity

The Government intends to introduce Regulatory Reform Bills into Parliament on a regular basis. The purpose of these Bills will be to enact various regulatory reforms that will seek to reduce the compliance burden for taxpayers and ensure that existing laws operate as intended (for example, streamlining of tax registration thresholds). It is not designed to consider new policy ideas or significant changes to the tax system.

Reforms can be proposed by tax practitioners, members of the public, the ATO, the Board of Tax, Treasury or any other interested parties and can be made via the Tax Sounding Board being proposed by the Board of Taxation.

ATO guidance on new legislation

The Budget Papers also say that Government will ‘support’ the ATO in its recent initiative to produce Law Companion Guidelines to explain new or contentious areas. Guidelines have been published by the ATO since 2015 to accompany the release of legislative measures such as the proposed AMIT provisions, country-by-country reporting for transfer pricing, the new small business restructure regime and the multinational anti-avoidance law.

The announcement says these Guidelines will be produced at the same time as the legislation is drafted. The Budget announcement notes that Guidelines will not have the status of legislation, which confirms the current position that Guidelines derive their effect from the rules governing ATO rulings.

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