2015 FEDERAL BUDGET REPORT

The Winners and Losers

Winners:

- Small business
- Rural business
- Northern Australia

Losers:

- Tax avoiding multi-nationals
- Online consumers
- Foreign Investors
- Not-for-Profits
- Fly-in fly-out workers
- Short-term residents

SMALL BUSINESS TAX PACKAGE

The small business package is designed to stimulate the sector through tax cuts and incentives for small business owners to invest in their businesses. These reforms occupy a large part of the Government's 2015 budget agenda. It is to be hoped they achieve their aim of stimulating small business investment and growth.

For small business owners (and prospective small business owners), these proposals provide some minor but welcome relief. The incentives for investment may have a positive impact on investment, with marginal investments becoming more attractive. In addition, the reduction in the tax rate for small business individuals may stimulate spending, as this produces real cash impacts for qualifying individuals.

However, many of the changes are marginal at best. The extension to the Fringe Benefits Tax (FBT) exemption for work related electronic devices is not expected to materially stimulate investment.

What is a small business?

For the purpose of these new concessions, and the small business concessions already contained within the income tax legislation, a small business is any entity (individual, trust or company) that is operating a business with an annual turnover of less than $2,000,000 (when aggregated with the turnovers of associated entities).

TAX CUTS

The tax cuts for small business entities will commence from 1 July 2015.

Companies

For companies that are small business entities, the income tax rate will reduce from 30% to 28.5% (on taxable income). For example, a small business company that derives $100,000 in taxable income will pay income tax of $28,500 (reduced from $30,000). This is a positive for companies that remain under the $2,000,000 turnover threshold.

However, when companies grow, and ultimately exceed the $2,000,000 small business threshold, they will be taxed at 30% on their full taxable income. This may be a disincentive to accelerate business growth, much like bracket creep acts as a deterrent for individuals to earn more income.

The dividend franking rate for small business companies will remain at 30%. This means the shareholders will still receive a 30% franking offset when they receive franked dividends. However, it appears that if a company is paying a lower amount of income tax, there will be fewer franking credits to pass on to shareholders.

INCENTIVES FOR SMALL BUSINESS RESTRUCTURES AND START-UPS

Capital Gains Tax (CGT) rollover relief

Historically, structuring small business entities has been difficult. As businesses grow, different types of entities may (or may no longer) be appropriate. Where small businesses restructure, their owners may be liable for CGT, as there are currently few effective and appropriate CGT rollovers available for small business restructures.

To allow for greater flexibility in small business structures, the Government has announced restructures of small business entities will attract CGT rollover relief. These new measures will apply from 1 July 2016.

Immediate deduction for professional fees for start-ups

The Government announced it will allow businesses to immediately deduct a range of professional expenses associated with starting a new business. Currently, some professional costs associated with a new business start-up are deducted over a five-year period as 'blackhole expenditure'.

It is proposed that business establishment costs such as professional, legal and accounting advice will be deductible. This may include, for example, legal expenses incurred in establishing a new company, trust or partnership.

These amendments will take effect from 1 July 2015.

Accelerated depreciation

Small businesses will be able to claim an immediate deduction for assets they start to use or install ready for use, where the asset costs less than $20,000. This represents a significant increase from the existing write-off threshold of $1,000 that currently applies for assets acquired from 1 January 2014.

The $20,000 threshold will apply to assets acquired and installed ready for use between 12 May 2015 and 30 June 2017. From 1 July 2017, the thresholds revert back to the existing arrangements.

Assets valued at $20,000 or more will not be immediately deductible. However, they may be placed in the small business depreciation pool and depreciated at 15% in the first year and 30% in subsequent years. The pool can be immediately deducted if the balance falls below $20,000 over the period (including existing pools).

Eligible assets

Accelerated depreciation will apply to the majority of capital asset types including cars, machinery and equipment. A small number of assets will not be eligible for the immediate write-off, including horticultural plants and in-house software. In most cases, specific depreciation rules apply to these assets.

The Government also announced it will suspend the current 'lock out' laws for the simplified depreciation rules until 30 June 2017. The lock out laws prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out.

FBT concessions

Under the current FBT provisions, employers can provide their employees with one portable electronic device, such as a laptop or tablet, without attracting FBT. This concession is limited to devices that are primarily used for work related purposes.

However, employers are able to provide employees with more than one device provided those devices perform substantially different functions. This has been a source of some confusion and dispute, especially where laptops, tablets and smart phones are involved.

To address this confusion, small business entities will be able to provide their employees with more than one work related device, irrespective of whether those devices perform substantially identical functions.

This amendment will take effect from 1 April 2016.

ACCELERATED DEPRECIATION FOR PRIMARY PRODUCERS

For income years commencing on or after 1 July 2016, the Government will allow all primary producers to immediately deduct capital expenditure on fencing and water facilities, such as dams, tanks, bores, irrigation channels, pumps, water towers and windmills. In addition, the Government will also allow primary producers to depreciate over three years all capital expenditure on fodder storage assets, such as silos and tanks, used to store grain and other animal feed.

The measure represents a significant reduction in the relevant asset lives, which are currently three years for water facilities, 30 years for fences, and up to 50 years for fodder storage assets.

The Government claims the measure will improve the resilience of primary producers who face drought, assist with cash flow, and reduce red tape by removing the need for primary producers to track expenditure over time; as well as improve environmental outcomes by incentivising fence construction

GOODS AND SERVICES TAX

Expansion of the GST base to include offshore supplies and intangibles

The Government has announced its strategy on how it will seek to impose GST on supplies to Australian customers by overseas based suppliers. In addition to imposing GST on intangible supplies, the draft amendments to the GST Act also seek to impose GST on all forms of supplies (including professional and consultancy services) to 'Australian customers' by overseas based suppliers, other than supplies of goods or real property. These changes will take effect from 1 July 2017 and seek to eliminate any previous GST advantages available to non-resident suppliers in the Australian market.

Summary of the measures

GST will be levied on intangible supplies of digital products (such as downloading of movies, music, apps, games, e-books) to 'Australian consumers'. GST will also be levied on other services such as consulting and professional services undertaken offshore for 'Australian consumers'.

An 'Australian consumer' is defined as an Australian resident who is not registered or required to be registered for GST, or registered but not entitled to full input tax credit recovery. Business-to-business transactions will not be impacted by these changes.

The definition of 'Australian consumer' focuses on the overall tax residency of the consumer, rather than the physical location of the consumer at the time the supply is made.

In certain circumstances, the operator of an Electronic Distribution Service (EDS) may be liable for GST on the supply to the 'Australian consumer' (on the basis that they may have greater access to information about the customer's residency). The EDS is not liable if they have no substantive involvement in making the supply.

If, based on all the information available, the supplier reasonably believes that the consumer is not an 'Australian consumer', the supplier will be treated as having made the supply to a non-resident (even if it is later determined that the customer was in fact an 'Australian consumer'). At this stage, no guidance is provided on what constitutes reasonable steps for the purpose of utilising this carve out.

A modified GST registration and remittance scheme will be introduced for offshore intangible suppliers whereby they can elect to forgo claiming any input tax credits for GST paid in return for access to the simplified GST registration and remittance scheme.

Other GST items highlighted in the budget

The Government announced that it will not be proceeding with a reverse charge mechanism for disposals of going concerns and farm land. It was proposed that the reverse charge mechanism would replace the current GST-free treatment for supplies of going concerns and farm land. The reason noted for not proceeding with the measure is that it would have resulted in adverse consequences for taxpayers.

The Government announced that it will be providing $265.5 million to the Australian Taxation Office over three years to continue a range of activities to promote GST compliance. The funding is to assist the Australian Taxation Office to identify activities such as under-reporting of GST, fraudulently obtaining GST refunds, failing to lodge GST returns and outstanding GST debts. It is expected that this measure will result in a net improvement to the Budget of $445 million with $1.8 billion in additional GST revenue being paid to the States and Territories.

The Government did not comment on whether the $1,000 low value threshold for purchases of foreign goods would be reduced. After much speculation that the threshold would be reduced, the Government's silence is likely to indicate that the issue is still being considered. We expect that further announcements will be made in relation to this issue in the near future.

ZONE TAX OFFSET RESTRICTED

The Government has announced that it will restrict the eligibility for taxpayers to claim the zone tax offset (ZTO) in an effort to align with the original intent of the policy.

At present, a taxpayer is eligible for the ZTO if they reside or work in a specified remote area for more than 183 days in an income year. This concessional tax offset is currently available to individuals who reside in specific remote areas where the cost of living is higher due to isolation or harsh environmental factors.

The ZTO will be amended to exclude fly-in-fly-out (FIFO) and drive-in-drive-out (DIDO) workers whose normal residence is not actually in the eligible zones. This measure is effective from 1 July 2015.

Although the Government did not change the offset amount, it is estimated that 20% of current claimants will no longer be eligible for the offset, which is estimated to increase revenue by $325 million over the next three years. This furthers the original intention of the offset whereby only residents of unfavourable climates can claim a tax benefit, not those who are eligible only by way of fly-in-fly-out employment.

CHANGES TO TAX RESIDENCY RULES FOR TEMPORARY WORKING HOLIDAY MAKERS

The Government has announced changes to the taxation of temporary working holiday makers in Australia from 1 July 2016.

Holiday makers currently on working holiday visas may be treated as Australian tax residents if they meet the tax residence requirements. The ATO typically seeks to treat anyone in Australia for longer than six months as a tax resident under the current law. This allows the taxpayer to enjoy a tax-free earnings threshold and access to the low income tax offset. This also means income earned under $37,000 is taxed at a lower income rate of 19%.

The changes announced in the Budget look to remove the ability for people who are temporarily in Australia on working holidays to be classified as Australian tax residents, regardless of whether they meet the current tax residence requirements. This will mean that those affected will be taxed at 32.5% from the first dollar of income earned.

WORK-RELATED CAR EXPENDITURE OPTIONS REDUCED

From 1 July 2015 taxpayers will only have two methods available to calculate and claim their work-related car expenses – the cents per kilometre and log book methods. Additionally, the sliding scale of deductions available under the cents per kilometre method based on vehicle engine size will be removed and replaced by a flat rate for all vehicles. The change is expected to result in budget savings over the forward estimates of $845 million. No changes have been made to the existing substantiation requirements.

Changes to the cents per kilometre method

The current law requires taxpayers to know their engine size and type to determine what set rate is used in calculating their claim, to a maximum of 5,000 business kilometres.

The proposal will remove the sliding scale and replace it with a flat rate of 66 cents per kilometre for all claims regardless of the engine size or type. This rate was derived from motoring association data of the average running costs for the top five selling motor vehicles.

Taxpayers owning medium or large sized cars will be impacted under this change by denying a tax deduction of up to 11 cents per kilometre - a maximum reduction of $550 in deductions per car per year.

Methods being discontinued

The current law allows for two additional methods of calculating work-related car expenses – the 12% of original value and the one-third of actual expenses methods. Both of these methods were only available to taxpayers where work-related travel exceeded 5,000 kilometres in an income year.

Although the Government states that less than 2% of taxpayers will be impacted by this change, taxpayers who used the 12% of original value method will be required to increase their record keeping efforts to include substantiation of their running costs on an annual basis, and taxpayers using the one-third of actual expenses method may lose a proportion of their claim where the business usage in their log books is less than 33.3%.

These measures put an increased burden on taxpayers to maintain records in relation to work-related car expenses, if they wish to maximise their entitlement to a tax deduction

FRINGE BENEFITS TAX (FBT) CAPPING AND REPORTING OF ENTERTAINMENT BENEFITS FOR FBT

One separate grossed-up cap of $5,000 per employee for salary sacrificed meal entertainment and entertainment facility leasing expenses is proposed to apply to not-for-profit employers from 1 April 2016. This budget measure confirms the announcement made last week by the Assistant Treasurer. This is in addition to the current caps (i.e. the $30,000 or $17,000 caps) that already apply to many not-for-profits.

Further, the measure states that all meal entertainment benefits will become reportable.

For small businesses (less than $2 million aggregate turnover), there will no longer be a limit of one portable electronic device per employee per year in order to access the exemption from FBT. The provision of all electronic devices, so long as primarily used for work related purposes, will be exempt.

Entertainment benefits will no longer be fully exempt or rebatable

The current FBT law provides that meal entertainment and entertainment facility leasing expenses are fully exempt or fully rebatable for certain employers. This means these expenses are not subject to the grossed-up caps and accordingly, no FBT is payable. The caps for the 2016-17 FBT year are $31,177 for public benevolent institutions (PBIs) and health promotion charities, and $17,667 for public and non-profit hospitals and public ambulance services.

In addition, these expenses are not currently reportable on employee PAYG payment summaries.

The proposed changes mean employers will be liable to FBT in full, where the grossed-up value of entertainment benefits exceeds $5,000 (which equates to $2,329 in benefits that are subject to GST). However, where the employee has not fully utilised the general $31,177 or $17,667 cap with other benefits, entertainment benefits can exceed the $5,000 cap to the extent of the unutilised general cap.

CHANGES TO THE FOREIGN INVESTMENT FRAMEWORK

Further to the Government's announcement on 2 May 2015, the 2015- 16 budget has confirmed the introduction of a number of changes to Australia's foreign investment framework. The proposed measures are expected to raise $115 million of revenue in 2015-16 and a total of $735 million revenue for the years 2015 to 2019.

Current regime

Australia's current foreign investment regime does not allow foreign investors to purchase existing residential properties. There are currently no application fees required for screening of foreign investment applications. The penalties for breach of the current law (e.g. foreign person acquiring property without approval) include criminal penalties (up to $85,000 in fines for individuals or two years imprisonment) and divestment orders.

New reforms

These measures are intended to commence on 1 December 2015. The key new measures are:

- The ATO will take over compliance and enforcement of these rules, utilising its data-matching systems
- There will be stronger criminal and civil penalties for breaches
- The introduction of application fees to administer screening for foreign investments
- Increased scrutiny around agriculture investments
- Increased transparency of these measures.

Stronger penalties

Criminal penalties for breach of the rules will be increased to a maximum of $127,500 for individuals (or three years imprisonment) and $637,500 for companies. There are also civil penalties of 10% of the purchase price or market value along with the payment to the Government of any profit on sale. These penalties are supplemented by lower criminal and civil penalties for lesser infringements or breaches as well as for voluntary disclosure.

Application fees

New application fees will be introduced for residential real estate proposals and rural land acquisitions (land used wholly and exclusively for carrying on a business of primary production). Application fees of up to $5,000 will apply for properties valued under $1 million, and up to $10,000 for properties equal to or greater than $1 million.

A further fee of $10,000 will be applied incrementally for each additional $1 million in property value thereafter. There will also be an upfront application fee of $25,000 for advanced off-the-plan certificates.

Privately owned investors from Free Trade Agreement partner countries investing into Australian business, commercial real estate or agriculture have the following threshold and application fees.

TYPE OF ACQUISITION	PREVIOUS THRESHOLD (INDEXED ANNUALLY)	NEW THRESHOLD (INDEXED ANNUALLY)	APPLICATION FEE FROM 1 DECEMBER 2015
Developed commercial real estate (including heritage-listed properties)	$1,094 million	$1,094 million	$25,000
Vacant commercial land	$0	$0	$10,000
Business acquisitions in non-sensitive sectors	$1,094 million	$1,094 million	$25,000 (or $100,000 for business acquisitions where the value of the transaction is greater than $1 billion) $10,000 if an internal reorganisation
Business acquisitions in sensitive sectors	$252 million	$252 million	$25,000 (or $100,000 for business acquisitions where the value of the transaction is greater than $1 billion) $10,000 is an internal reorganisation
Rural land	$1,094 million	$1,094 million for United States, New Zealand and Chile $15 million (cumulative) for China, Japan and Korea	Rural land less than $1 million: $5,000 Rural land equal to or greater than $1 million: $10,000, (then $10,000 incremental fee per additional $1 million in rural land value, capped at $100,000)
Agribusinesses	$1,094 million	$1,094 million for United States, New Zealand and Chile $55 million for China, Japan and Korea	$25,000 (or $100,000 for agribusiness acquisitions where the value of the transaction is greater than $1 billion)

Prior approval for rural land

As of 1 March 2015, foreign investors must obtain prior approval for a proposed acquisition of an interest in rural land where the cumulative value of the rural land owned by the foreign investor, including the proposed purchase, is $15 million or more. All proposed direct investments by foreign government investors, including in agriculture, will continue to be reviewed regardless of value.

Employee share scheme changes

As previously announced during the *Mid-year Economic and Fiscal Outlook 2014-15* (MYEFO), a number of significant changes were made to the taxation of employee share schemes. These changes aimed to make employee share schemes more accessible to all companies in Australia, support start-up companies and boost entrepreneurial activity.

Additional changes announced in the Budget (but already introduced into Parliament) aim to:

- Exclude eligible venture capital investments from the aggregated turnover test and grouping rules
- Provide the CGT discount to employee share scheme interests that are subject to the start-up concession, where options are converted into shares and the resulting shares are sold within 12 months of exercise
- Allow the Commissioner of Taxation to exercise discretion in relation to the minimum three-year holding period where there are circumstances outside the employee's control that make it impossible for them to meet this criterion.

These changes will take effect from 1 July 2015, along with the commencement of the other changes as announced in the MYEFO.

Recovery of HECS HELP Repayments from Overseas Residents

The Government will introduce new measures to the *Higher Education Loan Programme* (HELP) repayment framework to ensure payments are recovered from overseas residents. Any Australians residing overseas for a period greater than six months will be required to make repayments of the HELP debt, subject to the minimum repayment thresholds. Under the current system, overseas debtors are under no legal obligation to repay HECS, but may do so voluntarily

These new arrangements will apply from 1 January 2016 to both new and existing debts. The Government has estimated that it will recover $26 million over four years due to these measures.

Increasing the Medicare levy low-income thresholds

From July 2014, the Government will increase the Medicare levy low-income threshold to reflect CPI, so low-income taxpayers will continue to be exempt from paying the Medicare Levy. The threshold for singles will be increased to $20,896 (up from $20,542) while the threshold for couples with no children will be increased to $35,261 (up from $34,367). The additional threshold amount for each dependent child or student will be increased to $3,238 (up from $3,156). The applicable threshold for seniors and pensioners will be increased to $33,044 (up from $32,279).

Income Tax Exemption for government employees delivering overseas aid removed

From 1 July 2016, government employees who earn income while delivering Official Development Assistance overseas for more than 90 continuous days will no longer be exempt from paying income tax in Australia on these foreign earnings. Australian Defence Force and Australian Federal Police personnel and individuals delivering Official Development Assistance for a charity or private sector contracting firm will remain eligible for the exemption.

New Child Care Subsidy

From 1 July 2017, a new Child Care Subsidy (‘CCS’) with a new activity test will be introduced as summarised below:

ANNUAL FAMILY INCOME (ESTIMATED FOR 2017-18)	CCS PER CHILD	CCS ANNUAL CAP
Up to $65,710	Lower of 85% of actual fee or benchmark price	No
$65,711 to $170,710	Lower of between 85% to 50% of actual fee or benchmark price	No
$170,711 to $185,710	Lower of 50% of actual fee or benchmark price	No
Over $185,710	Lower of 50% of actual fee or benchmark price	Yes - $10,000 per child

Superannuation conditions of release changes

From 1 July 2015, the Government will allow people with a terminal medical condition to access their superannuation funds at an earlier date. At present, taxpayers are able to access superannuation funds where certified medical specialists affirm that life expectancy is less than 12 months. The amendment will allow access to superannuation funds where life expectancy is less than 24 months.

Age Pension asset test

The Government has confirmed its previous announcement on 7 May 2015 that the Age Pension asset test thresholds will be increased from $202,000 to $250,000 for a single homeowner and $375,000 (up from $286,500) for a couple as at 1 January 2017. However, the assets test taper rate at which the Age Pension begins to phase out will be reduced. This results in the maximum value of assets that a homeowner couple can hold and qualify for a pension will be reduced from $1.15 million to $823,000.

Furthermore, the Government has announced that any pensioners that lose pension entitlements as an effect of these changes will be automatically issued with a Commonwealth Seniors Health Card.