AUSTRALIAN FEDERAL BUDGET ANALYSIS 2017/18

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The 2017/18 Federal Budget was marketed as one of "security, fairness and opportunity"; however, it will likely be remembered as the budget of new taxes and big spending! Yet, the Government is forecasting a return to surplus in 2020/21.

The big ticket items this year include a new levy on banks, additional tax integrity measures, some tinkering around housing affordability, small business measures, an increase to the Medicare levy, amendments to GST and finally a range of infrastructure spending.

The real success of this year's budget will be determined by whether the forecast to surplus actually stacks up. Remember, the $24 billion deficit created by the small business tax cuts passed by Parliament yesterday has to be made up before the new spending measures are covered.

Does it deliver on the dreams of families, as the Prime Minister promised? Certainly not in the short term. As for the long term, we will have to wait and see.

KEY BUDGET MEASURES

THE NEW MAJOR BANK LEVY

The five biggest Australian banks (having liabilities of at least $100 billion) must pay the new major bank levy from 1 July 2017. The rate of the levy is 0.06% of a range of a bank's liabilities, raising $6.2 billion over the forward estimates period. On average, this is in effect an increase in the tax impost on the five banks from 30% to 35%.

Rightly or wrongly, the Australian banks have faced extensive criticism in recent years for extraordinary profits and the Government believes the major bank levy represents a fair additional contribution. It is also key to note that this new levy is not a tax on bank profits, and so does not result in franking credits for shareholders. The Budget papers imply that the levy will be deductible and, if so, the levy will reduce the corporate tax intake (so the headline $6.2 billion is actually $4.3 billion) and will further reduce franking credits for shareholders.

Australian families may also be affected if the levy is passed on to consumers despite the rhetoric of the Government. To this end, the Government is placing its bets on healthier competition to reduce the price of borrowing and is encouraging the mobility of customers from the big banks to other financial institutions.

These measures complement the packages to increase accountability in the financial sector, including a residential mortgage pricing inquiry by the ACCC, the creation of a new Australian Financial Complaints Authority for dispute resolution and a new Banking Executive Accountability Regime which will make senior bank executives subject to APRA oversight.

TAX INTEGRITY MEASURES

The Budget introduces a range of tax integrity measures targeting various aspects of the economy and increases funding to the ATO.

Expansion of the MAAL

The "Multinational Anti-Avoidance Law" (MAAL) will be amended to negate the use of foreign trusts and partnerships in corporate structures that circumvent the current law. For the most part, these changes are uncontroversial and remedy some of the MAAL's teething issues. The ATO previously released a Taxpayer Alert (TA 2016/11) which identifies this issue and the ATO's intention to deny such practices.

Black economy

The ATO will receive additional funding to target the black economy. This includes measures specifically targeting businesses of under $15 million turnover and extensions to the taxable payments reporting system (TRPS) to contractors in the courier and cleaning industries.

Other measures

Treasury has also announced other tax integrity measures, including:

1. **Self-Managed Superannuation Funds (SMSFs)**: Tightening the "related party transaction" rules to ensure SMSFs pay an arm's length rate for expenses (from 1 July 2017).
2. **Mismatches re Additional Tier 1 (AT1):** Eliminating hybrid tax mismatches that occur in cross-border transactions relating to regulatory capital known as AT1.

HOUSING AFFORDABILITY

The Budget proposes a range of new housing affordability measures. It is always difficult to predict the impact of these measures, but initial impressions are that they will not have a material positive impact on housing affordability. Some of these measures are outlined below.

Capital gains tax for foreign investors

The foreign resident capital gains tax (CGT) withholding rules will be tightened from 1 July 2017, with the withholding rate set to increase from 10% to 12.5%, and the value at which land will be caught by the rules to drop from $2 million to $750,000. Whilst this will have an obvious impact on the owners of residential property, the announcement seems to reach much further to capture all transactions (including, importantly, business transactions where there is underlying Australian land).

Unoccupied property charge

Foreign investors who own property that is left unoccupied for at least 6 months will be subject to a yearly charge which will broadly equal their FIRB application fee; as little as $5,000 a year. The charge will only apply to new foreign investors. There is potential for some unoccupied homes to be double-taxed (ie. under the Victorian unoccupied property measures).

Affordable housing investment through MITs

From income years starting on or after 1 July 2017, managed investment trusts (MITs) will be eligible to acquire, construct, or redevelop affordable housing. Non-resident investors in MITs are generally subject to a 15% final withholding tax on all distributions. To be eligible, the MIT must hold the investment for at least 10 years and must derive at least 80% of its assessable income from affordable housing, which must be provided to low to moderate income tenants for below market rate rent. The remaining 20% of income must be derived from other eligible investment activities under the MIT rules. Otherwise, distributions will be subject to a 30% final withholding tax rate.

Increase in CGT discount for affordable property

The CGT discount for investments in affordable property will be increased from 50% to 60% from 1 January 2018. The affordable property must be managed through a registered community housing provider and must be held as an investment for at least three years. We have significant reservations with maintaining the CGT discount at the current level, let alone an increase.

First Home Super Saver Scheme

First home buyers will be eligible from 1 July 2017 to salary sacrifice their earnings (ie. pre-tax) into a superannuation account which they can later withdraw to help fund their first home deposit. Contributions are taxed on the way in at 15%. Withdrawals include a deemed rate of return (currently at 4.78%), and will be subject to the individual's applicable marginal tax rate less 30%. Contributions will be capped at $15,000 per year, and $30,000 overall.

Limiting deductions for owners of investment properties

From 1 July 2017, property investors cannot claim deductions for depreciation on existing assets acquired with a property (where the contract of purchase is entered into after 7:30pm on 9 May 2017) and travel expenses related to inspecting, maintaining or collecting rent (unless incurred to a third party performing property management services). These changes will no doubt reduce deductions available to investors, however the impact is expected to be limited given the narrow range of expenses to which the measures apply. The treatment of assets with new home purchases is yet to be determined.

SMALL TO MEDIUM BUSINESS

Immediate write-off for assets

The Government has extended the small business $20,000 asset instant write-off measure for another year to 30 June 2018, which should be welcomed by the small business community. This measure continues to allow businesses with turnover of up to $10 million to claim an upfront deduction when they acquire eligible assets that cost up to $20,000.

Restriction of CGT concessions

The Government will introduce an integrity measure to prevent taxpayers from accessing small business CGT concessions which are unrelated to their small business. The concessions will only be available to taxpayers in respect of assets used in their eligible small businesses (rather than other assets). The measures will apply from 1 July 2017.

INDIVIDUALS AND FAMILIES

From 1 July 2019, the Government will increase the Medicare Levy from 2% to 2.5%. These measures apply following the expiration of the Budget Repair Levy on 30 June 2017. A family with a single income earner of $150,000 will then have to pay an additional $750 of tax per year under this measure. The increased Medicare Levy will be used to fund the NDIS and Medicare.

GOODS AND SERVICES TAX (GST)

The GST announcements in this year's Budget are as follows:

GST treatment of digital currency

From 1 July 2017, the Government will align the GST treatment of digital currency (such as Bitcoin) with money to ensure that consumers are no longer subject to "double taxation" when using this digital currency. In addition, this will remove an obstacle to the growth of the Financial Technology (Fintech) sector in Australia.

Combatting fraud in the precious metals industry

The Government is amending the GST law with effect from 1 April 2017 to provide that entities buying gold, silver and platinum that have been supplied by way of a taxable supply are required to reverse charge the GST - that is, the buyer will be liable to remit the GST to the ATO instead of the seller. Changes are also made to clarify that gold, silver and platinum are not second-hand goods.

Improving the integrity of GST on property transactions

As another GST integrity measure, from 1 July 2018, the Government will strengthen compliance with the GST law by requiring purchasers (rather than developers, as per the current law) of newly constructed residential properties or new subdivisions to remit the GST directly to the ATO as part of settlement. The Government anticipates that the purchasers' lawyers or conveyancers will bear the administrative burden of this measure.

HEY BIG (INFRASTRUCTURE) SPENDER...

The Budget has allocated $75 billion in big ticket infrastructure spending, most announced prior to the release of the Budget. This includes:

+ The Western Sydney Airport;
+ The Melbourne to Brisbane Inland Rail Project;
+ Snowy Mountains Hydro Scheme 2.0, with acquisition of ownership interests held by the States;
+ Roads in Queensland;
+ Fiona Stanley Hospital precinct in WA;
+ Regional rail and the Tullamarine Airport rail connection in Victoria; and
+ $10 billion in other rail projects across the country, subject to a proven business case (is major infrastructure not already a proven business case?). This may (potentially) include the Western Sydney Airport Rail Link (although most would say that is an essential part of a successful Western Sydney Airport).

These are extremely commendable projects and some are long overdue. Speed of delivery will be important to economic development, and the Government must ensure that the projects are future-proofed. To ensure the benefits of this expenditure flow through to Australia, careful choices of development partners will need to be made.

KEY ANNOUNCED BUT UNENACTED MEASURES

It is also worthy to note the key measures currently in the pipeline. These measures have previously been announced by the Government but are yet to be fully enacted:

Reforming the tax consolidation rules

There are a number of outstanding tax consolidation measures, including the churning, value shifting, TOFA, deductible liabilities, deferred tax liabilities and securitised assets measures, which are yet to be enacted.

Reducing the company tax rate

The Government announced its plan in the 2016/17 Budget to reduce the corporate tax rate progressively to 25% by 1 July 2026. Although only the first phase of the measure has been implemented, the Government remains committed to the full 10-year plan.

Reforming taxation of financial arrangements (TOFA) rules

As part of the 2016/17 Budget, the Government proposed to reform the TOFA rules to reduce the scope, decrease compliance costs and increase certainty.

Implementing a new suite of collective investment vehicles (CIVs)

Investors should keep an eye out for the introduction of two new types of CIVs which were announced by the Government in the 2016/17 Budget.

Enhancing access to asset backed financing

Diverse sources of capital should be more accessible once barriers to the use of asset backed financing arrangements are removed (such as deferred payment arrangements and hire purchase arrangements). This was announced in the 2016/17 Budget.

Applying GST to low value goods imported by consumers

On 9 May 2017, the Senate Committee recommended that the Bill applying GST on low value goods be passed, but that the implementation date be deferred to 1 July 2018.

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