DEWINGS ACCOUNTING + CONSULTING

2018-19 Federal Budget

This year's Federal Budget - the third handed down by Treasurer Scott Morrison - is rightly being called an 'election' Budget. The flagship item is the measure to reduce personal tax rates and increase tax offsets for low and medium income earners. Beyond that, however, there's little for business owners to get excited, or agitated, about. There are still a few bright spots though. The Budget is predicted to return to a small surplus a year earlier than previously estimated (by 2019-20), and for the first time in a while, there are some logical, positive changes to superannuation fund management and compliance.

Here are a few of the budget highlights.

- $20,000 instant asset write-off measure extended
- Research and development incentive changes
- Treatment of loans from companies to trusts (UPEs) to come under Div 7A
- Personal tax rate reductions
- Tax relief for low and middle-income earners
- Medicare Levy to remain at 2%
- ATO compliance activity to increase
- Self-Managed Super Fund member limit increase
- Three-year audit cycle for SMSFs with good compliance history
- Work test exemption for some recent retirees
- High-income earners can opt out of Super Guarantee where concessional cap is exceeded
- Super Fund trustees required to prepare retirement income strategy for members

Business

- **$20,000 instant asset write-off measure extended** - This could almost be a standing item in our annual Budget newsletter. It's a welcome measure though. Once again, the $20,000 instant asset write-off measure for small businesses has been extended for another year. This allows 'small' businesses to claim an outright deduction for business assets costing less than $20,000, rather than depreciating them over a number of years. The provision will now continue at least until 30th June 2019 and will apply to businesses with annual turnover less than $10 million.

- **Research and development incentive changes** - This is an exceptionally complex area of tax law, but in short, these changes will link research and development tax incentives (R&D) to the 'intensity' of the R&D activities - that is, the proportion of R&D expenses to the other expenditure of the business. The effect for many businesses undertaking eligible R&D activities will be a

significant reduction in the R&D offset they are entitled to. This goes against the recommendations of a number of industry bodies and seems short-sighted for a Government that regularly touts 'innovation' as the future of the nation.

- **Treatment of loans from companies to trusts (UPEs) to come under Div 7A** - From 1st July 2019, unpaid present entitlements (UPEs) will come within the scope of Division 7A of the Income Tax Assessment Act 1936. Division 7A requires benefits provided by private companies to related taxpayers to be taxed as dividends unless they are structured as Div 7A complying loans (or another exception applies). This measure will ensure that a UPE between a company and trust is either required to be repaid to the private company over time as a complying loan or will be subject to tax as a dividend.

Personal tax

- **Personal tax rate reductions** - The Government suggests that up to 80% of all personal taxpayers will get some benefit from this announcement. At its centre is a long-term plan to reduce the number of personal income tax brackets, from five to four. The first stage commences next year - the 2018-19 financial year - by increasing the upper threshold of the 32.5% rate from $87,000 to $90,000. Then from 1st July 2022, the upper threshold for the 19% rate will increase from $37,000 to $41,000 while the threshold for the 32.5% rate will further increase from $90,000 to $120,000. Finally, beginning 1st July 2024, the 37% tax bracket will be eliminated altogether. Currently, this applies to taxable income between $87,000 and $180,000. Instead, the 32.5% rate will be extended right up to $200,000.

  Addressing the problem of 'bracket creep' is a necessary and welcome correction, but the proposed implementation strategy is once again to be carried out over a long, and therefore ambiguous, timeline. There will be at least two Federal elections between now and 2024, and quite possibly at least one change of Government. Further, Budget announcements are frequently abandoned in very short timeframes (sometimes the very next year) as other concerns take priority, which generally means that only announcements slated for immediate effect are ever likely to be legislated. Even then, the makeup of the Senate makes passage of legislation difficult, and this seems unlikely to move away from its recent pattern of uncertainty. Labor has signalled its intent to support the first round of changes. What happens beyond that really is anyone's guess.

- **Tax relief for low and middle-income earners -** A new Low and Middle Income Offset will be introduced from 1st July 2018. It will provide a $200 offset for those earning up to $37,000 a year, then increase gradually to a maximum of $530 for those earning between $48,000 and $90,000 per annum. After this, it will again gradually reduce until it cuts out entirely for those earning over $125,333. This will be provided in addition to the current Low Income Tax Offset (currently $445 up to $37,000, then phasing out to nil for those earning more than $66,666 per year), which is also to increase to a maximum of $645 from 1st July 2022. Offsets are not received by taxpayers during the year but are used to offset tax payable when a tax return is lodged. In the case of these two measures, if the taxpayer has paid no tax at all, the excess offset amounts are not refundable, i.e. they can only reduce tax payable to a minimum of zero, no more. While this will no doubt be great news for those who are impacted by it, it is again excessively convoluted. Two offsets that phase out at different rates and thresholds, targeting many of the same taxpayers, with the new offset gradually increasing before it is then gradually reduced to zero! Perhaps a single offset to replace both may have been simpler?

- **Medicare Levy to remain at 2%** - Last year's proposed increase in the Medicare Levy to 2.5% will not proceed. The rate will remain at the current level of 2%.

- **ATO compliance activity to increase** - Not a new measure, but definitely worthy of note, the ATO will be given an extra $130.8 million to increase compliance activities which will target individuals and their tax agents. In their cross-hairs is likely to be claims for work-related deductions, though this has not been explicitly stated in the Budget papers. In addition, an extra $137.7 million will be provided for improved debt collection systems, and a further $318.5 million over four years to combat the black economy. That's close to $600 million, and you can safely assume that the Government and the Tax Office will be looking for a considerable return on that investment. It will be more important than ever for taxpayers to exercise caution in their affairs, and especially to ensure that all claims can be adequately substantiated and have the necessary connection to income earning activity.

Superannuation

- **Self-Managed Super Fund member limit increase** - The maximum allowable number of members in new and existing SMSFs will increase from four to six from 1st July 2019. This will benefit larger families, for example, where the children of existing members wish to join the fund for, say, intergenerational planning purposes.

- **Three-year audit cycle for SMSFs with good compliance history** - In one of those rare announcements that actually reduces the compliance burden on taxpayers, the current requirement that SMSFs be audited every year will be relaxed for funds that have a good history of record keeping and compliance. From the start of the 2019-20 financial year, they will only require an audit every three years, which should hopefully reduce the time and cost of maintaining an SMSF. It may require a change in business strategy for auditors though!

- **Work test exemption for some recent retirees** - Currently, super funds cannot accept contributions from members who are over 65 years of age, but less than 75, unless the member meets the 'work test'. This test requires that the member has worked at least 40 hours in a consecutive 30 day period during the financial year. From 1st July 2019, an exemption from the work test will be available for individuals aged 65-74, for the first year they do not meet the test, where their balance in the fund is less than $300,000.

- **High-income earners can opt out of Super Guarantee where concessional cap is exceeded** - A problem can arise for higher income earners who work in more than one job, because each employer must contribute up to the total Superannuation Guarantee limit for the employee, and thereby in total, across all employers, the member may exceed their concessional contribution limit (currently set at $25,000). In effect, a breach of the concessional caps occurs inadvertently simply by way of the employers fulfilling their individual Superannuation Guarantee obligations. From 1st July 2018, this inconsistency will finally be remedied so that affected employees can instead choose to take the excess as income instead of Superannuation Guarantee contributions.

- **Super Fund trustees required to prepare retirement income strategy for members** - Adding further to the compliance obligations of SMSF trustees, an additional document will be required for members in order to provide a retirement income strategy. This will be in addition to the current requirement for an investment strategy and insurance consideration.

Our take...

Refreshingly, there's not a lot to dislike in this year's Budget, from a tax and business point of view.

Personal tax cuts are always welcome, particularly where they are intended to address bracket creep, however there may be a case to be made for better targeting of Budget savings towards growth measures - for example cutting business red tape, or extending rather than restricting R&D incentives -

rather than simply handing them back as tax cuts.

But there's also not a lot for business to love about this Budget either. An increased infrastructure spend will hopefully make conducting business in Australia easier for some, and is certainly much needed. Noticeably absent once again though is any real strategy for significant tax reform and in particular, any proposal for simplifying the compliance burden for Australian businesses.

Ultimately this really is an election Budget in every sense of the word - good for newspaper headlines but unfortunately lacking in any bold new initiatives for growth.

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