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Global Tax Alert

Australia issues 2020-21 Federal Budget

EY Tax News Update: Global Edition

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Executive summary

The Australian Federal Budget 2020 was delivered on 6 October 2020 by the Federal Treasurer Josh Frydenberg.

Economic and overall policy issues in the 2020 budget are outlined on the EY Australia website.

This Tax Alert focuses on the key tax measures announced, to assist entities with tax business planning and compliance processes.

The key challenge for Australia in the COVID-19 recovery phase is to support investment and consumption by providing support to business and households. Businesses with aggregate turnover greater than AU$5 billion (b)[1] may benefit from the retention of the research & development tax incentives (R&DTI), removal of the Fringe Benefits Tax (FBT) on re-training or re-skilling, clarification of the central management and control test, the ambition to expand Australia's treaty network and to make improvements to treaties with strategic partners, as well as flow on impacts.

Building a better working world

The clear winners from the Budget tax measures are middle income earners and businesses with aggregate turnover under $5b. These measures include:

- Bringing forward of personal income tax cuts to 1 July 2020[2]
- Immediate expensing of assets used or installed by 30 June 2022[2]
- Tax loss carrybacks for company losses incurred up to 2021-22[2]
- Removal of low-yielding tax imposts such as FBT on re-training and reskilling costs and increased access to small business FBT exemptions
- A welcome increased access to small business tax concessions for businesses with aggregated turnover less than $50 million (m)[2]

Other notable measures include:

- Reversing the Government's previous intention to significantly cut the R&D regime[2]
- International tax measures including clarification of Australia's corporate tax residency test and modernizing and expanding Australia's tax treaty network
- New "JobMaker" initiatives to provide wage subsidies for young unemployed hiring and creation of new apprenticeships and traineeships.
- Supporting manufacturing industries through grants and incentives

It is a positive development to see the adoption of a number of measures supported by EY over a number of years, including wage subsidies for unemployed workers, tax loss carrybacks, and simplification of FBT and R&D measures.

While the Budget tax measures are welcomed, it is unfortunate that the mooted Investment Allowance of at least 20% did not eventuate. Given the current low cost of funding, tax incentives that simply bring forward tax deductions may not be enough to make marginal projects viable.

Looking beyond the Budget, international competition for investment is expected to be fierce, with many countries facing the same challenges expected to adopt expansionary fiscal policy during the COVID-19 recovery phase. The case for comprehensive, structural tax reform in Australia is compelling. However, this will be a challenge to deliver.

Bolder tax policy settings that increase Australia's international competitiveness, by reducing the effective tax rates applicable to new investments are what's needed.

Detailed discussion

Tax changes announced in the Budget

This Tax Alert outlines the key tax changes affecting:

- Business tax
- Employment taxes
- International businesses
- Personal taxes
- Financial services and tax administration

Business tax measures

Temporary full expensing of depreciating assets

New assets

The availability of instant asset write offs (IAWO) has been extended to businesses with aggregated turnover of less than $5b.[3] These measures apply to new, eligible capital assets acquired after 7:30pm AEDT on 6 October 2020 which are either first used or installed by 30 June 2022. No threshold applies to the value of each eligible asset.

The measures also allow for an instant write off for the cost of improvements to existing eligible assets made before 30 June 2022.

Assets of entities with aggregated turnover of $50m or more where a commitment to incur the cost in relation to the asset was entered into before 7:30pm AEDT on 6 October 2020 are excluded.

Secondhand assets

The instant tax write off measures available for small- and medium-sized businesses (with an aggregated turnover of less than $50m) have been extended to allow for the full expensing of the cost of second-hand assets.

If a depreciating asset of a business with turnover between $50m and $500m is not eligible for temporary full expensing, they are still able to deduct the full cost of second-hand assets costing less than $150,000 which are purchased by 31 December 2020. These businesses now have until 30 June 2021 to first use or install the assets.

Small businesses

Small businesses (with aggregated turnover of less than $10m) will also be able to deduct the balance of their simplified depreciation pool at the end of the income year while the measures are in operation.

The measures can be used in conjunction with the loss carryback measures.

The new measures may represent a significant opportunity for many businesses and confirmation of eligibility and consideration of requirements in planning will be important. Application is not optional and if this results in little or no taxable income some tax attributes may be lost (e.g., FITOs).

Access to small business tax concessions extended

Access to current small business tax concessions will be extended to businesses with an aggregated turnover[3] between $10m and $50m, including:

- Immediate deduction for certain start-up expenses and prepaid expenditure – from 1 July 2020
- FBT exemption on car parking and multiple work-related portable electronic devices, such as phones or laptops, provided to employees – from 1 April 2021
- Simplified trading stock rules, remitting Pay As You Go installments based on Gross Domestic Product adjusted notional tax, settling excise duty and excise-equivalent customs duty monthly and a two-year amendment period for income tax assessments, excluding entities which have significant international dealings or complex affairs - from 1 July 2021

The Commissioner of Taxation's power to specify simplified accounting methods for Goods and Services Tax (GST) purposes will also be expanded to businesses with aggregated annual turnover below $50m – from 1 July 2021.

Carryback of tax losses

Tax losses of corporate tax entities incurred in the fiscal year (FY)20 to FY22 years can be carried back to offset taxable income in FY19 or later years, generating a refundable tax offset for taxes paid in those earlier years. Eligible entities may elect to receive a tax refund when they file their 2020-21 and 2021-22 income tax returns (including carryback tax losses for the 2019-20 income year).

In combination with the enhanced instant asset write off deduction, some companies will be able to subsidize capital asset purchases in FY21 and FY22 via refunds of tax paid in FY19 and FY20.

To qualify, a company's aggregated turnover[3] must be less than $5b in the year of the loss, therefore excluding companies within very large global organizations. The quantum of tax losses that can be carried back is limited to the taxable income derived in the earlier years converted into a tax equivalent amount at the entity's corporate tax rate for the loss year and must not produce a franking account deficit for the company.

The loss carryback provisions include integrity rules consistent with those that applied under the previous 2013 year loss carryback rules.

R&DTI - A new intensity test and significant improvements

There are significant changes proposed to the R&DTI from 1 July 2021, with a new intensity test, improved benefit rates, uncapped or higher caps on R&D expenditure, simplicity and greater certainty.

All claimants accessing the non-refundable R&D tax offset will receive a benefit of between 8.5% and up to 16.5% (above the corporate tax rate), and all claimants under the refundable R&D tax offset will receive a benefit of 18.5% (above the corporate tax rate).

In total this represents an additional $2b in business R&D support over the forward estimates, encouraging business to accelerate innovation and R&D across the economy. Combined with improved funding for the Commonwealth Scientific and Industrial Research Organisation (CSIRO) and University research this sends a very positive signal about the role innovation is expected to play in the economic recovery.

While the decrease in the corporate tax rate for companies with turnover of less than $50m to 25% from 1 July 2021 will erode some of the benefits for companies with turnover above $20m and with R&D intensity of 2% or less (measured against total expenses of the R&D entity), the new system should deliver increased incentives over the previously proposed R&D intensity test, and will mean most companies accessing the R&DTI keep the same, or get higher levels of benefit, than the current system.

Above all bipartisan support for the measures should translate into fast passage of the law and improved certainty about the future longevity of the system.

In summary, the changes are as follows:

Businesses - turnover below $20m (refundable tax offset)

Turnover	New R&D Tax Offset	Current R&D Tax Offset	Benefit Impact
Below $20m	18.5% (+25% corporate tax rate) = 43.5%	43.5%	18.5% benefit confirmed

Businesses - turnover above $20m (non-refundable tax offset)

Turnover	R&D Intensity	New R&D Tax Offset	Current R&D Tax Offset	Benefit Impact
Between $20m - $50m	0-2%	8.5% (+25% corporate tax rate) = 33.5%	38.5%	5% lower
	Above 2%	16.5% (+25% corporate tax rate) = 41.5%*		3% Increase (max)
Above $50m	0-2%	8.5% (+30% corporate tax rate) = 38.5%	38.5%	No change
	Above 2%	16.5% (+30% corporate tax rate) = 46.5%*		8% Increase (max)

* Only applies to R&D expenditure increment above 2% R&D intensity

There will be no cap on the amount of refundable R&D tax offsets and the cap for eligible R&D expenditure for non-refundable offsets will increase from $100m to $150m per annum. Additional changes to the administration of the program and increased transparency as previously proposed will also be applied.

Companies with existing eligible R&D can work on the basis previously legislated changes before Parliament will not go ahead. Those considering expenditure on future R&D projects, should incorporate these favorable proposed changes in the financial models.

Export Market Development Grants (EMDG) overhaul

Significant changes are proposed to the EMDG from 1 July 2021 which will create an eligibility-based grant program, with entities able to access funding for multiple years through a pre-application system. Eligible entities will be restricted to annual turnovers of less than $20m (currently $50m).

Modern Manufacturing Initiative – Support for manufacturers

Provides $1.5b over five years focusing on building competitiveness, scale and resilience in the Australian manufacturing sector. This includes $1.3b for projects centered around collaboration, translation and integration activities for manufacturers, as well as adoption of new technologies, focused in the following six national manufacturing priority areas:

- Food and beverage manufacturing
- Resources technology and critical minerals processing
- Medical products
- Recycling and clean energy
- Defense industry
- Space industry

Investment in new energy technologies

An additional $1.4b over 12 years to continue funding the Australian Renewable Energy Agency (ARENA) to provide R&D investment for emerging low emission technologies to increase their commercial readiness, as well as $500m of other funding for investment in other low emissions technologies and network infrastructure.

Key focus areas include:

- Hydrogen (including from gas)
- Soil carbon sequestration
- Carbon capture and storage
- Production of green-steel
- Industrial processes to reduce energy consumption

Making Victoria's business support grants non-assessable, non-exempt (NANE) income

Victorian Government business support grants for small and medium businesses will be made NANE income for income tax purposes.

Grants announced on or after 13 September 2020 and payments made between 13 September 2020 and 30 June 2021 will be eligible for this treatment. This arrangement can be extended to similar grants in all States and Territories on an application basis.

Employment tax measures

Fringe benefits tax changes

As actively supported by EY, an FBT exemption will be introduced for certain employer-provided retraining and reskilling costs, for employees who are redundant or soon to be made redundant - from 2 October 2020. FBT is currently payable on employer training that is not sufficiently connected to an employee's current employment. It is hoped this change will encourage employers to help workers transition to new employment opportunities.

The Government will also consult on potential changes to allow tax deductions to employees for such training undertaken at their own expense.

Other FBT changes include:

- Small business FBT exemptions on car parking and multiple work-related portable electronic devices will be extended to businesses with an aggregated annual turnover up to $50m – from 1 April 2021.
- Some compliance relief will be provided by allowing employers to rely on existing records rather than having to collect declarations, provided the Commissioner accepts such records as adequate alternative records – from 1 April following Royal Assent of the changes.

JobMaker – further initiatives

New "JobMaker" initiatives will provide wage subsidies to encourage hiring of young unemployed individuals and the creation of new apprenticeships and traineeships.

- Effective 7 October 2020, eligible employers will be able to claim the JobMaker Hiring Credit for jobs created for eligible employees aged 16 to 35. The Hiring Credit will be paid quarterly in arrears at the rate of $200 per week for those aged 16 to 29 and $100 per week for those aged 30 to 35 (an annual maximum of $10,400 per position). Employers will need to demonstrate an increase in overall employee headcount and payroll for each position created.
- Employees will need to have worked for a minimum of 20 hours per week and received the JobSeeker Payment, Youth Allowance (other) or Parenting Payment for at least one month out of the three months prior to when they are hired.
- A further enhanced 50% wage subsidy for apprentices and trainees will be available from 5 October 2020 to 30 September 2021, for businesses of any size, capped at 100,000 places, up to $7,000 per quarter per eligible apprentice or trainee.

International business measures

Clarifying the corporate residency test

As expected, the Government has announced it will clarify the circumstances in which a foreign incorporated company will be classified as Australian tax resident for domestic income tax purposes. The announcement follows a period of significant uncertainty since the Bywater Investments & Ors v Commissioner of Taxation (Bywater) decision in 2016 and the Australian Taxation Office's (ATO) subsequent withdrawal and replacement of TR 2004/15 with TR 2018/5 and practical compliance guide PCG 2018/9.

The announcement is also in response to the consultation process and reports issued by the Board of Taxation (BoT) on the matter. The Government did not respond to all the recommendations in the final BoT report released on 7 October 2020. But foreign incorporated companies will only be considered Australian tax resident if they have a "significant economic connection with Australia" as well as their central management and control from date of Royal Assent to amending legislation.

Taxpayers will have the option of applying the new rule retrospectively from 15 March 2017, the date when TR 2004/15 was withdrawn. However, it is unknown whether this will be via administrative practice or legislative instrument.

It remains to be seen how the legislation will be amended with concepts around "significant economic connection with Australia" defined "around core commercial activities" or whether the existing alternative test of voting power being controlled by Australian residents is retained. The interaction of domestic tax law with tax treaties, especially in the context of the new multilateral instrument model, will also need to be considered.

In essence, the position following the announcement returns the focus to those foreign incorporated companies who were the focus pre-Bywater and the withdrawal of TR 2004/15, i.e., passive investment of holding companies and mere decision making not being enough for a significant economic connection.

The proposed changes will warrant careful analysis by relevant corporations when details are issued.

Modernizing and expanding Australia's tax treaty network

The Government will support the recovery from COVID-19 by modernizing and expanding the country's tax treaty network to eliminate double taxation, settle taxing rights between Australia and other countries and to attract foreign investment and skilled workers. Refurbishing Australia's treaties with key strategic partners where necessary to maximize the benefits for Australia's economy will be a priority.

Tax treaties benefit both businesses and individuals. They provide greater certainty for international transactions, lowering the cost of doing business overseas. They also provide relief from double taxation to attract skilled foreign workers to Australia. Reducing tax barriers will promote trade and investment. By attracting foreign investment and skilled workers, treaties raise productivity, creating better jobs and supporting higher incomes.

Personal taxes

Personal income tax changes

As anticipated, the already legislated second stage of the personal income tax relief plan announced in the 2019-20 Budget (which built on the Government's 2018/19 plan), to provide tax relief to low- and middle-income earners, that was scheduled to commence from 1 July 2022, will now commence retrospectively from 1 July 2020.

The ATO will publish updated tax withholding schedules once the amendments pass Parliament, or when there is public bipartisan support for the Bill to bring forward the tax cuts, to allow the tax cuts to be reflected in employee's take home pay.

Bracket adjustments

- Stage 2 brought forward - Increase in top threshold for the 19% income tax bracket to $45,000 (from $37,000), increase in top threshold for the 32.5% income tax bracket to $120,000 (from $90,000) from 1 July 2020 (originally from 1 July 2022).
- Stage 3 unchanged - Consolidate the 32.5% and 37% rates into one 30% bracket for incomes from $45,001 to $200,000 from 1 July 2024.

Rate*(%)	2019-20 ($)	2020-21 to 2023-24 ($)
0	0 - 18,200	0 - 18,200
19	18,201 - 37,000	18,201 - 45,000
32.5	37,001 - 90,000	45,001 - 120,000
37	90,001 - 180,000	120,001 - 180,000
45	180,001 +	180,001 +

Rate*(%)	2024-25 onwards
0	0 - 18,200
19	18,001 - 45,000
30	45,001 - 200,000
-	-
45	200,001 +

*Rates do not include Medicare levy of 2%

Non-refundable low and middle income tax offset (LMITO) retained

The ILMITO, which was due to be removed with commencement of Stage 2, has been retained for the 2020/21 income year. Taxpayers with taxable income:

- Up to $37,000 (paying 19 cents on the dollar) will have their tax reduced by up to $255
- More than $37,000 (paying 32.5 cents on the dollar) will see offset increase by 7.5 cents per dollar (maximum $1,080 for incomes $48,000 -$90,000)
- Over $90,000 the offset will reduce by 3 cents per dollar in excess, zeroing out at $126,000

Low income tax offset (LITO) increase

- The LITO will be increased to $700 (from $445) and will reduce at 5 cents per dollar of taxable income between $37,500 and $45,000 and 1.5 cents per dollar over $45,000 zeroing out at $66,667
- Applies from 1 July 2020, was previously scheduled to apply from 1 July 2022

Medicare levy threshold increases

The Medicare levy thresholds will also be adjusted from the 2019-20 income year.

Individuals and employers should ensure that personal income tax rate changes are factored into tax planning, payroll and compliance processes.

Capital gains tax (CGT) exemption for granny flat arrangements

A CGT exemption will be introduced for the creation, variation or termination of a formal written granny flat arrangement, entered into because of family relationships or other personal ties, providing accommodation for older Australians or people with disabilities. The measure will have effect from the first income year after Royal Assent.

Financial services and tax administration

Updated list of Information Exchange Countries

As Hong Kong is a major international financial center, it is positive that, in response to an EY submission, from 1 July 2021, Hong Kong resident investors will be eligible for the concessional 15% withholding tax on certain Managed Investment Trust (MIT) distributions. Other countries included in the list are Dominican Republic, Ecuador, El Salvador, Jamaica, Kuwait, Morocco, North Macedonia and Serbia.

However, Kenya will be removed from the list.

Foreign investors should factor in this favorable change when making investment decisions. MITs and their custodians and administrators will need to update systems.

Additional funding for the ATO

The Government will provide additional funding to the ATO:

- The ATO will receive an additional $15.1m to support its ongoing efforts in targeting serious organized crime in the tax and superannuation systems. This extends a previous Budget measure to 30 June 2023.
- For the purpose of facilitating the effective delivery of the next phase of the JobKeeper Payment and the JobMaker Hiring Credit programs, the ATO will receive $305.9m over four years. We expect "effective delivery" to include compliance activity.

Endnotes

1. Currency references in this Alert are to the AU$.
2. A Bill was introduced into the House of Representatives on 7 October 2020 to implement this measure.
3. Aggregated turnover is broadly the annual turnover of the entity plus the annual turnover of the entity's connected entities and affiliates (including overseas entities).

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