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Global Tax Alert

Australia re-elects Federal Coalition Government: Impact on tax policies

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Executive summary

The Australian federal election on 18 May 2019 saw an unexpected victory by the Liberal-Nationals Coalition (Coalition). The Coalition will form a majority government with at least 77 seats in the House of Representatives.

In the Senate, the Coalition may face a smaller economically-conservative crossbench reduced from 10 members to 6. With the Senate count 55.1% complete on 21 May:

- The Coalition will likely have up to 34 Senators (13 won + 4 likely + 1 in doubt; plus 16 continuing)
- Labor will likely have 26 Senators (12 won + 1 likely; plus 13 continuing) and 9 Greens (6 likely; plus 3 continuing)
- Based on current counting, the Coalition needs either 5 of the 6 crossbench votes or all 6 to secure the 39 votes needed to pass legislation in the Senate
- The crossbench consists of up to two One Nation (one in doubt), two Centre Alliance and one Australian Conservatives representatives as well as Jacqui Lambie (likely)

The election writs need to be returned before Federal Parliament is recalled, which may not be until late June.

Building a better working world

Prime Minister Scott Morrison's new cabinet is likely to keep in place key personnel such as Josh Frydenberg (Treasurer) and Mathias Cormann (Finance). There are at least three cabinet vacancies caused by retirements.

The Coalition tax policies taken into the election were as outlined in the Federal Budget delivered just five weeks ago on 2 April by Treasurer Josh Frydenberg (see EY Global Tax Alert, *Australia's 2019/20 Federal Budget: A detailed review*, dated 3 April 2019) and the Coalition made no new tax policy announcements in the election campaign.

This Tax Alert reviews the Coalition tax policies and the tax policy state of play given:

- All outstanding tax bills lapsed when the election was called and need to be formally reintroduced by the incoming Government
- The bill to amend Research and Development (R&D) tax incentives announced in the 2018 budget, were reviewed by a Senate committee which recommended adjustment
- The various pre-election unlegislated measures need attention to reduce uncertainty
- Some government policies may be opposed in the Senate

Businesses will need to consider these issues and their impact on disclosures, tax provision accounting and tax governance processes as they move to the 30 June balance date. This is particularly relevant in respect of the R&D tax incentive and whether this measure will continue with the 1 July 2018 start date in the original Bill. Businesses may also wish to consider providing input to the Government on these and other policy issues.

This Tax Alert comments also on the tax policy opportunities for the Government.

Detailed discussion

The broader tax policy environment

Corporate tax rate cuts for larger companies, a feature of the 2018 Federal Budget, was narrowly rejected by the Senate and therefore shelved for the 2019 Federal Budget and not part of the Coalition's election campaign. A single corporate tax rate of 25% for all companies regardless of size by the 2026/27 income year seems off the table for now. Depending on how the economy and Senate composition develops over time, this could be revisited over the mid- to long-term.

There might be opportunities for the Coalition to consider carefully targeted reforms focused on enhancing jobs growth and capital investment if Australian economic growth does not improve through 2019.

The Coalition announced several key tax measures in the Federal Budget on 2 April 2019 setting up a blueprint for upcoming legislative developments under the Government. As outlined in our 2019 Budget Tax Alert, the budget was focused on achieving a budget surplus in 2019-20 (which might potentially occur this year) with a mix of measures commencing soon plus measures with deferred start dates after the budget repair process.

Consistent with the commitment to keep the overall tax revenue collection to 23.9% of Gross Domestic Product, the 2019 budget tax policies saw:

- Tax cuts for small to medium companies (businesses with turnovers of less than AU$50 million[1])
- Personal tax rate cuts in three stages, discussed below
- The immediate tax write-off deduction for capital equipment was increased from $20,000 to $30,000 for the business portion of each asset (new or second hand), purchased and first used or installed ready for use from 7:30 pm (AEDT) on 2 April 2019 until 30 June 2020
- Fine-tuning of the international hybrid mismatch rules, discussed below

First Home Loan Deposit Scheme

Although the Coalition did not announce any new tax measures during the election campaign its announcement of a new First Home Loan Deposit Scheme (FHLDS) will have potential economic impact:

- The FHLDS announced by the Coalition on 12 May 2019 is designed to assist first home buyers who are struggling to reach the 20% deposit requirement imposed by lenders, by allowing them to apply for a home loan where appropriate with a down payment of as little as 5%. The Scheme will help first home buyers save around $10,000 by not having to pay Lenders Mortgage Insurance.
- The FHLDS will start on 1 January 2020 and is targeted towards first home buyers earning up to $125,000 for singles or $200,000 for couples annually (equating to around 10,000 first home buyers annually). The value of homes that can be purchased under the Scheme will be determined on a regional basis, reflecting the different property markets across Australia.

A key uncertainty – the R&D incentive

A key policy imperative for business and Government is to resolve the 2018 budget changes proposed to the R&D rules, effective 1 July 2018, notably to change the R&D incentive for larger companies to utilize an intensity test and changes to the rate of benefit for smaller companies – as detailed in EY's Global Tax Alert, *Australia issues 2018-19 Federal Budget*, dated 11 May 2018.

The intensity test and other changes to the R&D tax offset program, were included in a Bill which the Senate Economics Legislation Committee reviewed, and subsequently recommended adjustment of the Bill given the problematic policy settings.

The intensity test reduces the non-refundable R&D tax offset for many companies in a way that the Senate Committee, EY and many businesses find problematic. The test as currently drafted works against companies with a strong Australian manufacturing footprint as they are likely to have a lower R&D intensity ratio due to the scale of non-R&D activity with a potential drop of the offset from 8.5% to 4%. In contrast, those who engage in Australian R&D but produce predominantly overseas may reach high intensity and see the offset increase to 12.5%. Additional changes were also proposed that would reduce and cap the level of benefit for some smaller companies.

The Australian Labor Party (ALP) went into the election with a policy of not scaling back the R&D incentives and instead reviewing the overall R&D policy with a focus on enhancing innovation and collaboration between business and academia, including the introduction of a specific 10% collaboration premium incentive.

Business is focused on reducing uncertainty in the taxation system, and the R&D Bill needs to be resolved as an urgent policy priority. Given the 30 June balancing companies are less than two months away from year end, the precise tax treatment of their R&D expenditures needs to be clarified as a matter of urgency.

The policy urgency could potentially see the Government reintroduce the Bill unchanged. Consequently, affected businesses should be engaging with the Government soon on this issue should they wish to see policy refinements.

The revenue cost of deferring and rethinking the R&D policies might not be severe, given the further falloff in Australian businesses' R&D expenditure, again confirmed in the April 2019 Budget, which is a worrying trend.

Budget measures which require development and introduction

Clarifying operation of the hybrid mismatch rules

These include, to introduce into the hybrid mismatch rules:

- Clear rules for application to multiple entry consolidated (MEC) groups and trusts
- Limitation on the meaning of foreign tax
- Adjustment of the integrity rule

After the Budget, Treasury released a statement of policy intent which sets out policy principles.

Personal Tax Relief

The Coalition Government's tax centerpiece of the Budget and the pre-election campaign was staged around personal income tax relief, building on the Coalition's legislated 2018/19 Personal Income Tax Plan, to provide tax relief to low and middle-income earners.

Increasing the non-refundable low and middle-income tax offset (LMITO) for taxable incomes under $126,000

The reduction in tax provided by LMITO will increase to a maximum $1,080 per annum and the base amount will increase $255 per annum from the current 2018/19 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 their offset increase by 7.5¢ 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
- LMITO applies until the end of the 2021/22 income year

Low income tax offset (LITO) increase for taxable incomes under $66,667 from 2022

- The LITO will be increased to $700 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 2022

Personal Tax Bracket adjustments

- Increase in top threshold for the 19% income tax bracket to $45,000 (from $41,000), from 1 July 2022
- Reduce the 32.5% marginal tax bracket to 30%, from 1 July 2024

Rate (%)	2018-19 to 2021-22 ($)	2022-23 to 2023-24 ($)
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	18,201 - 45,000
30	45,001 - 200,000
–	–*
45	200,001 + *

*Rates take previously announced 2018/19 personal tax cuts into account, new changes marked in bold Rates do not include Medicare levy of 2%

When Federal Parliament is recalled depends on the return of the writs and therefore the personal tax relief may not get voted on until after 30 June. The Australian Taxation Office (ATO) has administrative processes to ensure taxpayers get the additional relief in the form of tax refunds.

Superannuation member reforms from 1 July 2020

Various measures to improve superannuation flexibility for older Australians are proposed from 1 July 2020:

- "Work test" age limit increase: The eligibility age will increase from 64 to 66 for individual's contributing superannuation without the need to satisfy the "work test." This applies to both concessional and non-concessional contributions.
- "Bring forward contributions" age limit will increase from age 64 to 66, allowing individuals to contribute three years of non-concessional contributions in a single year, up to $300,000.
- Spouse contributions age limit increase from 69 to 74. This will allow individuals to make contributions on behalf of their spouse for a longer period.

Superannuation fund reforms

Permanent tax relief for merging superannuation funds

The current tax relief for merging large superannuation funds will be made permanent (currently due to expire 1 July 2020). This should assist the rationalization of the superannuation industry.

Reducing red tape for Superannuation Fund Trustees

From 1 July 2020, an actuarial certificate will no longer be required where all fund members are in the retirement phase and fund earnings are allocated on a proportionate basis.

Updated list of Information Exchange Countries

The list of Information Exchange Countries will be expanded on 1 July 2020 to add Curacao, Lebanon, Nauru, Pakistan, Panama, Peru, Qatar and the United Arab Emirates. Once appropriately listed, the withholding tax on certain Managed Investment Trust (MIT) distributions to these countries will reduce from 30% to 15% and foreign investors should factor this into investment decisions. MIT custodians and administrators will need to update systems.

Hong Kong is still not mentioned but given the significance of Hong Kong as an investment location and entry into force of the Mutual Assistance Convention, it is expected there may be scope for businesses to seek acceleration of Hong Kong being listed by 2020.

Reintroduction of pre-election measures lapsed in Parliament

Australia's 45th Parliament was prorogued on 11 April 2019. All unpassed legislation before Parliament lapsed as a result. The Government now can reintroduce the lapsed measures into the 46th Parliament as new Bills depending on their politics, parliamentary position and priorities.

Equally there are opportunities to make representations to ask the Government to reconsider reintroduction of measures or to consider making further changes to measures before reintroducing them.

This chapter includes the key measures under Bills introduced by the Government that lapsed in Parliament in April 2019.

Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018

R&D tax incentive (R&DTI) reform from 1 July 2018

The R&DTI reform included:

- Increase in the R&D expenditure cap from $100m to $150m
- Cash refunds to be capped at $4m annually with an exception for clinical trials
- R&D intensity test for claimants eligible for the nonrefundable R&D tax offset on a sliding scale
- Offset rate will be a premium of 13.5% above the company tax rate

The Coalition acknowledged after Senate hearings that the R&D intensity test needed to be revisited as it was punitive for companies with economic scale including sizeable manufacturing and R&D in Australia favoring companies with sizeable R&D but limited production in Australia.

Thin capitalization asset valuation measure

The measure requires an entity to use the value of the assets, liabilities and equity from its financial statements and removes the ability to revalue for assets tax purposes, applying from 8 May 2018. Existing tax valuations in place on 8 May 2018 can only be relied on until 30 June 2019.

The measure also ensured that non-ADI foreign controlled Australian tax consolidated groups and MEC groups that have foreign investments or operations are treated as both outward investing and inward investing entities from 1 July 2019.

Significant global entity (SGE) definition expansion from 1 July 2018

SGE to include multinational groups headed by private, trust, partnership and investment entities under the measure. A transitional measure adjusted the SGE-related penalties application to 1 July 2019.

Goods and Services Tax (GST) on offshore sellers of hotel accommodation from 1 July 2019

The measure required offshore suppliers of rights or options to use commercial accommodation in Australia to include these supplies in working out their GST turnover.

Treasury Laws Amendment (2018 Measures No 2) Bill 2018

With application from 1 July 2018, the Bill proposed to amend the venture capital and early stage investor provisions in relation to Capital Gains Tax (CGT) transactions, MITs and the early stage investor tax offset and amended the definition of public trading trusts.

Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No 2) Bill 2018

Measures included:

- Removing the CGT main residence exemption for foreign residents from 9 May 2017
- Increasing the CGT discount by 10% for gains on affordable housing

Disposals by nonresidents from 1 July 2019 will no longer be entitled to the CGT main residence exemption. Affected taxpayers may want to get their voices heard to stop the measure from resurfacing or if it does, at least see an extended sunset clause.

Treasury Laws Amendment (2018 Superannuation Measures No 1) Bill 2018

The Bill included the 12-month superannuation guarantee amnesty for non-compliant employers, as well as other amendments to the superannuation guarantee contribution rules, the non-arm's length income rules and the total superannuation balance test broadly from 1 July 2018.

Treasury Laws Amendment (Combating Illegal Phoenixing) Bill 2019

The Bill included a range of measures targeting illegal phoenixing including penalties for directors and retaining tax refunds.

Treasury Laws Amendment (Putting Members' Interests First) Bill 2019

The Bill contained measures to prevent trustees from providing insurance to certain superannuation members on an opt-out basis from 1 October 2019.

Treasury Laws Amendment (Registries Modernisation and Other Measures) Bill 2019

The Bill is part of a package of Bills to modernize Commonwealth registers and to introduce a "director identification number" requirement.

Implementation of pre-election unlegislated measures

A number of measures have been outstanding at different stages of legislative development but were not introduced into Parliament prior to the 2019 Federal election. The Government might resume the legislative progress on these unlegislated measures for introduction into the Parliament.

The key outstanding unlegislated measures are mentioned below.

Unlegislated measures at the exposure draft stage

- Denying tax deductions for losses or outgoings incurred to the extent they relate to a taxpayer holding vacant land unless incurred during the course of carrying on a business from 1 July 2019
- Tax integrity measures to restrict small business CGT concessions to certain CGT events in relation to partnerships, from 8 May 2018
- Improving the integrity of the tax treatment of concessional loans between tax-exempt entities for the purposes of applying the TOFA provisions from 8 May 2018
- Extending anti-avoidance rules for circular trust distributions to family trusts enabling income tax on circular trust distribution at the top marginal tax rate plus medicare levy from 1 July 2019
- Proposed tax framework to introduce the Attribution Corporate Collective Investment Vehicle regime
- Improving the transparency of taxation debts to authorize the ATO to disclose business tax debts to credit reporting bureaus where the businesses have not effectively engaged with the ATO to manage their debt

Unlegislated measures at policy formulation stage

Private company loan rules – Division 7A reform

The 2018 budget deferred the start date for the reform program in relation to the treatment of private company loans and amendments to the Division 7A regime, to enable policy consultation to continue following a Treasury consultation paper on 22 October 2018.

Given that government's policy intent here had been different to the direction of reforms suggested by the Board of Taxation, it is likely the policy consultation might see some fine tuning of the proposed changes which included:

- Safe harbor rules for the use of assets
- Changes to improve the integrity and operation of Division 7A. The proposed changes to Division 7A will be effective from 1 July 2020

Other

- Taxation of income for an individual's fame or image to ensure all income derived from the exploitation of a person's image or fame is assessed to that person, and not to any other entity, from 1 July 2019
- Review of the (PRRT) Gas Transfer Pricing arrangements, following the Government's response on the PRRT Callaghan review
- Sharing economy platform providers reporting regime to enhance tax integrity of the sharing economy by imposing reporting obligations to sharing platform providers and financial institutions
- Employee Share Scheme regime reform to double the value limit, reduce public disclosures and make various other changes
- Amending Australia's Offshore Banking Unit Regime as the Organisation for Economic Co-operation and Development's Forum on Harmful Tax Practices has raised concerns on the concessional tax rate and the ring-fenced nature of the regime
- Tax impacts of implementing the new accounting standard for insurance contracts (AASB17) applying mandatorily for annual reporting periods beginning on or after 1 January 2021

Implications

With the 46th Parliament set to resume in late June 2019 and the new Senate to be formed on 1 July 2019, the Government will soon initiate the legislative development of new and carryover tax policies. This warrants businesses to monitor the Government's actions in terms of introduction of various unlegislated measures as well as reintroduction of the measures lapsed due to the election.

In case of reintroduced measures, it will be important for business to identify any adverse impact from the retrospective application of certain measures.

Endnotes

1. Currency references in this Alert are to AU$.

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