

2017/2018 FEDERAL BUDGET UPDATE

1. Personal income tax measures

1.1 Limiting plant and equipment depreciation deductions to outlays actually incurred by investors – for residential investment properties acquired from Budget night on 9 May 2017

From 1 July 2017, the Government will limit plant and equipment depreciation deductions to outlays actually incurred by investors in residential properties. Plant and equipment items are usually mechanical fixtures, or those that can be 'easily' removed from a property such as dishwashers and ceiling fans. These changes will apply on a prospective basis, with existing investments grandfathered. More specifically:

- Plant and equipment forming part of residential investment properties as of **9 May 2017** (including contracts already entered into at 7:30PM (AEST) on 9 May 2017) will continue to give rise to deductions for depreciation until either the investor no longer owns the asset, or the asset reaches the end of its effective life.
- Investors who purchase plant and equipment for their residential investment property **after 9 May 2017** will be able to claim a deduction over the effective life of the asset. However, subsequent owners of a property will be unable to claim deductions for plant and equipment purchased by a previous owner of that property. Acquisitions of existing plant and equipment items will be reflected in the cost base for CGT purposes for subsequent investors.

This is an integrity measure to address concerns that some plant and equipment items are being depreciated by successive investors in excess of their actual value.

1.2 No deduction for travel expenses for residential rental properties

From 1 July 2017, the Government will disallow deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property.

This is an integrity measure to address concerns that many taxpayers have been claiming travel deductions

without correctly apportioning costs, or have claimed travel costs that were for private travel purposes. This measure will not prevent investors from claiming a deduction for costs incurred in engaging third parties, such as real estate agents, for property management services.

2. Medicare levy-related changes

2.1 Increasing the Medicare levy low-income thresholds

The Government will increase the Medicare levy low-income thresholds for singles, families and seniors and pensioners **from the 2017 income year**.

- The threshold for singles will be increased to \$21,655.
- The family threshold will be increased to \$36,541 plus \$3,356 for each dependent child or student.
- For single seniors and pensioners, the threshold will be increased to \$34,244.
- The family threshold for seniors and pensioners will be increased to \$47,670 plus \$3,356 for each dependent child or student.

2.2 Increase in the Medicare levy from 1 July 2019

From 1 July 2019, the Government will increase the Medicare levy from 2% to 2.5% of taxable income. Other tax rates that are linked to the top personal tax rate, such as the fringe benefits tax rate, will also be increased. Low-income earners will continue to receive relief from the Medicare levy through the low-income thresholds for singles, families, seniors and pensioners. The current exemptions from the Medicare levy will also remain in place.

3. Measures affecting small businesses

3.1 Extending the \$20,000 immediate write-off for small business

Under current law, the \$20,000 immediate write-off ends on 30 June 2017. However, the Government has proposed to extend the concession by 12 months to **30 June 2018** for businesses with an aggregated annual turnover less than \$10 million.



This means small businesses will be able to immediately deduct purchases of eligible assets costing less than \$20,000 first used or installed ready for use by 30 June 2018. Assets valued at \$20,000 or more (which cannot be immediately deducted) can continue to be placed into the small business simplified depreciation pool (the pool) and depreciated at 15% in the first income year and 30% each income year thereafter. The pool balance can also be immediately deducted if the balance is less than \$20,000 over this period.

Further, the current 'lock out' laws for the simplified depreciation rules (these prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out) will continue to be suspended until 30 June 2018.

From 1 July 2018, the immediate deductibility threshold and the balance at which the pool can be immediately deducted will revert back to \$1,000.

3.2 New integrity measure for the small business CGT concessions

The Government will amend the small business CGT concessions with effect **from 1 July 2017** to ensure that the concessions can only be accessed in relation to assets used in a small business or ownership interests in a small business.

This proposed amendment is targeted at taxpayers who are able to access these concessions for assets which are unrelated to their small business, for instance through arranging their affairs so that their ownership interests in larger businesses do not count towards the tests for determining eligibility for the concessions.

The small business CGT concessions will continue to be available to small business taxpayers with aggregated turnover of less than \$2 million or business assets less than \$6 million.

4. Superannuation

4.1 First home superannuation saver scheme

The Government will encourage home ownership by allowing first homebuyers to 'build a deposit' inside their superannuation fund, as follows:

- Voluntary superannuation contributions of up to \$15,000 per year, and \$30,000 in total, can be contributed by first homebuyers **from 1 July 2017**.

The contribution must be within existing concessional and non-concessional caps. Concessional contributions are taxed at 15% in the fund and earnings on contributions are taxed at 15% in the fund.

- These contributions can then be withdrawn, along with associated deemed earnings, for a first home deposit, **from 1 July 2018 onwards**. Concessional contributions and earnings that are withdrawn will be taxed at the taxpayer's marginal rate less a 30% offset. When non-concessional contributions ('NCCs') are withdrawn, they will not be taxed.

Combined with the existing concessional tax treatment of contributions and earnings, this will provide an incentive that will enable first homebuyers to build savings more quickly for a home deposit. Note that, both members of a couple can take advantage of this measure to buy their first home together.

4.2 Limited recourse borrowing arrangements ('LRBAs')

From 1 July 2017, the Government will include the use of LRBAs in a member's total superannuation balance and transfer balance cap. Both of these concepts were initially proposed as part of the 2016/17 Federal Budget and are now legislated to apply from 1 July 2017.

By way of background, the concept of total superannuation balance is used to limit the ability of a fund member to make NCCs into superannuation (among other things) and the transfer balance rules are designed to limit the value that a fund member is able to transfer into the tax-exempt pension phase to \$1.6 million.

LRBAs can be used to circumvent contribution caps and effectively transfer growth in assets from the accumulation phase to the retirement phase that is not captured by the transfer balance cap. As such, the outstanding balance of a LRBA will be included in a member's annual total superannuation balance and the repayment of the principal and interest of a LRBA from a member's accumulation account will be a credit in the member's transfer balance account.

Note that this measure is already contained in exposure draft legislation – *Treasury Laws Amendment (2017 Measures No. 2) Bill 2017: superannuation reform package amending provisions*.



4.3 Individuals aged 65 or over able to contribute the proceeds of downsizing into superannuation

From 1 July 2018, the Government will allow a person aged 65 or over to make a NCC of up to \$300,000 from the proceeds of selling their home. These NCCs will be in addition to those currently permitted under existing rules and caps and they will be exempt from the existing age test, work test and the \$1.6 million balance test for making NCCs.

This measure will apply to sales of a principal residence owned for the past ten or more years and both members of a couple will be able to take advantage of this measure for the same home.

This measure reduces a barrier to downsizing for older people. Encouraging downsizing may enable more effective use of the housing stock by freeing up larger homes for younger, growing families.

Note: It is unclear how this measure will affect the assets test for aged pension purposes.

4.4 Extending tax relief for merging superannuation funds

The Government will extend the current tax relief for merging superannuation funds until 1 July 2020.

Since December 2008, tax relief has been available for superannuation funds to transfer capital and revenue losses to a new merged fund, and to defer taxation consequences on gains and losses from revenue and capital assets. This tax relief was due to lapse on 1 July 2017.

Extending this relief will ensure superannuation fund members' balances are not reduced by tax when superannuation funds merge.

4.5 Integrity of non-arm's length arrangements

From 1 July 2018, the Government will further improve the integrity of the superannuation system by reducing opportunities for members to use related party transactions on non-commercial terms to increase superannuation savings. The non-arm's length income provisions will be amended to ensure expenses that would normally apply in a commercial transaction are included when considering whether the transaction is on a commercial basis.

5. Measures affecting the GST regime

5.1 Improving the integrity of GST on property transactions

From 1 July 2018, purchasers of newly constructed residential properties or new subdivisions will be required to remit the GST directly to the ATO as part of settlement. Under the current law (where the GST is included in the purchase price and the developer remits the GST to the ATO), some developers are failing to remit the GST to the ATO despite having claimed GST credits on their construction costs. As most purchasers use conveyancing services to complete their purchase, they should experience minimal impact from these changes.

5.2 Aligning the treatment of digital currency (e.g., bitcoin) with money

From 1 July 2017, the Government will align the GST treatment of digital currency (e.g., Bitcoin) with money. Digital currency is currently treated as intangible property for GST purposes. Consequently, consumers who use digital currencies as payment can effectively bear GST twice: once on the purchase of the digital currency and again on its use in exchange for other goods and services subject to GST. This measure will ensure purchases of digital currency are no longer subject to the GST.

6. Measures affecting foreign investors

6.1 Measures applying from Budget Night on 9 May 2017

(a) CGT changes for foreign investors

The Government will extend Australia's foreign resident CGT regime by:

- denying foreign and temporary tax residents access to the CGT **main residence exemption** from 7:30PM (AEST) on **9 May 2017**. Note that existing properties held prior to this date will only be grandfathered until **30 June 2019**.
- applying the principal asset test on an **associate inclusive basis** for foreign tax residents with indirect interests in Australian real property from 7:30PM (AEST) on **9 May 2017**. This will ensure that foreign tax residents cannot avoid a CGT liability by disaggregating indirect interests in Australian real property.

(b) Charge on foreign owners of underutilised residential property

The Government will introduce a charge of at least \$5,000 on foreign owners of residential property where the property is not occupied or genuinely available on the rental market for at least six months per year. This measure will apply to foreign persons who make a foreign investment application for residential property from 7:30PM (AEST) on 9 May 2017.

The charge will be levied annually and will be equivalent to the relevant investment application fee imposed on the property at the time it was acquired by the foreign investor.

This measure is intended to encourage foreign owners of residential property to make their properties available for rent where they are not used as a residence and so increase the number of dwellings available for Australians to live in.

(c) Restricting foreign ownership in new developments to 50%

The Government will introduce a 50% cap on foreign ownership in new developments through a condition on New Dwelling Exemption Certificates. The cap will be included as a condition on New Dwelling Exemption Certificates where the application was made from 7:30 PM (AEST) on 9 May 2017.

New Dwelling Exemption Certificates are granted to property developers and act as a pre-approval allowing the sale of new dwellings in a specified development to foreign persons without each foreign purchaser seeking their own foreign investment approval. The current certificates do not limit the amount of sales that may be made to foreign purchasers. The measure will ensure that a minimum proportion of developments are available for Australians to purchase.

6.2 Measures applying from 1 July 2017

(a) Changes to the Foreign Resident CGT Withholding ('FRCGW') regime

The Government will extend Australia's FRCGW regime by increasing the CGT withholding rate for foreign tax residents from 10.0% to 12.5% from 1 July 2017.

The Government will also reduce the CGT withholding threshold for foreign tax residents from \$2 million to

\$750,000 from 1 July 2017.

(b) Streamlining and enhancing the foreign investment framework

The Government will introduce a range of amendments with effect from 1 July 2017, to clarify and simplify Australia's foreign investment framework. This will make foreign investor obligations clearer, and allow for more efficient allocation of Foreign Investment Review Board screening resources to higher risk cases. The amended framework will allow Australia's foreign investment framework to operate more efficiently by facilitating business investment and reducing unnecessary red tape.

7. Encouraging investment into affordable housing

7.1 Increased CGT discount for resident individuals investing in qualifying affordable housing

From 1 January 2018, the Government will increase the CGT discount from 50% to 60% for resident individuals who elect to invest in qualifying affordable housing.

To qualify for the higher CGT discount, housing must be provided to low to moderate income tenants, with rent charged at a discount below the private rental market rate. The affordable housing must be managed through a registered community housing provider and the investment held for a minimum period of three years.

The higher discount would flow through to resident individuals investing in qualifying affordable housing Managed Investment Trusts (refer below).

7.2 Affordable housing through Managed Investment Trusts ('MITs')

The Government will encourage investment into affordable housing by enabling MITs to invest in affordable housing. In order for investors to receive concessional taxation treatment through a MIT, the affordable housing must be available for rent for at least 10 years.

MITs allow investors to pool their funds to invest in primarily passive investments and have them managed by a professional manager. The MIT will be able to acquire, construct or redevelop the property but must derive at least 80% of its assessable income from affordable housing. Qualifying housing must be provided to low to moderate income tenants, with rent charged at a



discount below the private rental market rate. This measure will apply from income years starting **on or after 1 July 2017**.

Under the MIT withholding tax regime, non-resident investors are generally subject to a reduced rate of tax if they are a resident of a country with which Australia has an effective exchange of information treaty. Non-resident investors are generally subject to a 15% final withholding tax rate on fund payments from the MIT. Resident investors are taxed at their marginal tax rates, with capital gains remaining eligible for the CGT discount.

Up to 20% of the income of the MIT may be derived from other eligible investment activities permitted under the existing MIT rules in the income tax law. If this is breached, or less than 80% of the MIT's income is from affordable housing in an income year, the non-resident investor will be liable to pay withholding tax at 30% on investment returns for that income year. Properties held for rent as affordable housing for less than 10 years will be subject to a 30% withholding tax rate on the net capital gains arising from the disposal of those assets.

8. Black economy taskforce

8.1 Extension of the taxable payments reporting system to contractors in the courier and cleaning industries

The Government will extend the taxable payments reporting system ('TPRS') to contractors in the courier and cleaning industries with effect **from 1 July 2018**.

The TPRS is a transparency measure and already operates in the building and construction industry, where it has resulted in improved contractor compliance. Under the TPRS, businesses are required to report payments they make to contractors (individual and total for the year) to the ATO.

This measure brings payments to contractors in the courier and cleaning industries into line with wages, which are reported to the ATO. Businesses in these industries will need to ensure that they collect information from 1 July 2018, with the first annual report required in August 2019.

8.2 One year extension of funding for ATO audit activities

The Government will provide \$32 million for one year of additional funding for ATO audit and compliance

programs to better target black economy risks. This funding was to expire on 30 June 2017.

Under this measure, a further year of funding will be provided for the ATO's 'Strengthening Foundations' and 'Level Playing Field' programs. 'Strengthening Foundations' focuses on businesses with a turnover between \$2 million and \$15 million that have disengaged from the tax system. The 'Level Playing Field' program involves audit, review and intensive follow up and targeting small businesses with turnover below \$2 million.

These programs are directed at changing black economy and related behaviours such as non-lodgment, omission of income and non-payment of employer obligations.

8.3 Prohibition on sales suppression technology and software

The Government will act to prohibit the manufacture, distribution, possession, use or sale of electronic point of sale ('POS') sales suppression technology and software. The prohibition will have effect from the date of Royal Assent of the enabling legislation.

Sales suppression technology and software allow businesses to understate their incomes by untraceably deleting selected transactions from electronic records in POS equipment. Income earned from these transactions and tax owing from this income is not reported to the ATO.

9. Changes affecting the Higher Education Loan Program ('HELP')

The Government will revise the income thresholds for repayment of HELP debt, repayment rates and the indexation of repayment thresholds **from 1 July 2018**. A new minimum threshold of \$42,000 will be established with a 1% repayment rate and a maximum threshold of \$119,882 with a 10% repayment rate.

By way of background, for 2017/18, the minimum threshold is \$55,874 and the minimum repayment rate is 4%. The maximum threshold for 2017/18 is \$103,766 with an 8% repayment rate.

Please Note: Many of the comments in this publication are general in nature and anyone intending to apply the information to practical circumstances should seek professional advice to independently verify their interpretation and the information's applicability to their particular circumstances.