Prosperity or peril

Federal Budget 2017-18

2.5%
Medicare levy increased from July 2019

$75bn
spending on infrastructure over the next 10 years

Measures to stimulate housing supply and encourage investment in affordable housing

A forecast return to budget surplus by ***2021***

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Overview

Is trust the new budget currency?

Regaining trust, and not a return to budget surplus, was clearly Treasurer Scott Morrison's key objective for the 2017-18 Federal Budget.

In recent years the budget process has lost much of its economic credibility, and with a backdrop of growing distrust of institutions generally, the Government needed to push the reset button. It needed – to use the Treasurer's own words – an "honest budget".

So the 2017-18 Federal Budget has been framed around a suite of new institutions, new regulation, new levies and a significant foray into directly funding key national infrastructure programs and corporations.

The big banks, in particular, have been specifically targeted. There are new registration requirements for senior executives, a new regulatory agency to oversee

consumer financial services complaints, and a new levy on bank liabilities, which Treasury expects will raise $6.2 billion over the forward estimates. All are likely to pass the popularity test, with the electorate and the cross-benchers. But the economic impacts warrant careful consideration. Any mechanism that imposes a material cost on the financial system should be expected to adversely affect future investment and economic growth.

The Federal Budget is now a $460 billion endeavour. Though previous Budgets have gone to lengths to try to communicate where revenue comes from and what programs it supports, the Treasurer clearly thought this was not enough. The solution? Hypothecation – the policy of directly linking revenue mechanisms to specific expenditure programs. The Treasury historically has railed against such schemes, arguing they are inflexible and inefficient. But they are simple to explain and generally reasonably popular (as much as any tax or levy can be). So, the 2017-18 Federal Budget sees new hypothecation initiatives in the Medicare levy (now specifically attributed to a new Medicare Guarantee Fund, and with a 0.5 per cent increase to fund National Disability Insurance Scheme obligations) and a new levy on skilled migration (directed to a new Skilling Australians Fund).

After an underlying cash deficit of $29.4 billion in 2016-17, a surplus is now expected by 2020-21, with the budget balance to remain in the black thereafter. Indeed, the economic narrative of the budget was one of optimism. Economic growth will be modest this year, but pick up strongly next year and thereafter track at a healthy 3 per cent. This growth will then underwrite strong nominal growth in Commonwealth tax receipts. The only problem? We've heard this before. In virtually all recent budgets the forecast profile has been the same – a pick-up in economic growth 2-3 years out doing the budget heavy-lifting. The risk is that a slower-growth global economy will act as a drag on our economy, and with it, the lift in Commonwealth revenues expected to restore the fiscal balance.

One important difference this time is that the Government has finally addressed the so-called "zombie measures", that is, previously claimed budget savings measures with no realistic prospect of Senate support. Indeed, the combination of budget initiatives, targeting housing affordability, defence, infrastructure, welfare and tax system integrity, should make the path to a budget surplus far less exposed to Parliamentary hold-up.

02

Housing tax measures

As widely speculated in the lead up to this year's Federal Budget, the Government has announced a range of tax and superannuation measures to address housing affordability in Australia, particularly in the eastern States.

The following tax and superannuation related measures were announced as part of the Government's comprehensive housing package:

- increasing the capital gains tax (CGT) discount for Australian residents who invest in affordable housing
- measures to encourage investment in affordable housing through managed investment trusts (MITs)
- introducing of an annual charge on foreign owners of residential property that is left unoccupied or not available for rent
- changing the foreign resident CGT regime
- denying foreign investors and temporary residents access to the CGT main residence exemption
- introducing a first home super saver scheme to permit future contributions to superannuation funds to be withdrawn for a first home deposit
- permitting "down-sizers" to contribute some or all of the proceeds of selling their principal residence to superannuation as a non-concessional contribution above and beyond existing caps
- disallowing deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property, and
- limiting depreciation deductions to outlays actually incurred by investors in residential real estate.

As expected no changes were announced to limit negative gearing. Below, we have provided additional details on the key tax and superannuation aspects of this package.

Increased CGT discount for investing in affordable housing

From 1 January 2018, resident individual taxpayers will be granted an additional 10 per cent CGT discount for investments in qualifying affordable housing. This means that individuals investing in such properties will be entitled to a 60 per cent CGT discount (up from the existing 50 per cent discount). This benefit will also flow through MITs to resident investors as outlined below. The current one-third CGT discount for superannuation funds remains unchanged.

Whilst it is expected that the Government will consult further on the implementation of this policy, it has indicated that a property will qualify as “affordable” housing if rent is charged at below market rate and it is made available for eligible tenants on low to moderate incomes. Tenant eligibility will be based on household income and household consumption.

To qualify for this additional discount, the housing must also be managed through a registered community housing provider, and held as affordable housing for a minimum period of three years.

Furthermore, the Government has indicated that current investments in affordable housing through the National Rental Affordability Scheme (NRAS) will not be entitled to the 60 per cent CGT discount because NRAS providers already receive an annual financial incentive to supply affordable housing. In order to benefit from the additional 10 per cent CGT discount, investors will need to wait until their investments cease to be covered by NRAS.

Finally, the additional discount will not be limited to investments in new affordable housing but will also apply to existing properties if investors supply their property for affordable housing. In this context, if an individual rents out their property from 1 January 2018 as affordable housing, provided the investment meets the eligibility requirements, the 60 per cent CGT discount should be applicable from 1 January 2021.

Investment in affordable housing by MITs

In a welcome move, the Government will seek to encourage private sector and foreign investment in affordable housing by allowing MITs to acquire, construct or redevelop property to hold for affordable housing from 1 July 2017.

Much of the detail of this proposal is lacking, however it appears that the Government intends to amend the tax law to ensure that the acquisition, construction or redevelopment of affordable housing is an “eligible investment business”, attracting flow through taxation for resident investors (and thereby allowing them to access the CGT discount) and the concessional MIT withholding rates for foreign investors.

To be eligible for the concessional MIT withholding rates, the MIT must hold, and make available for rent, the affordable housing asset for at least ten years. Where the property is held for rent as affordable housing for less than ten years, certain foreign investors will still have access to the concessional 15 per cent withholding rate on investment returns, but will be subject to 30 per cent final withholding rate on the distribution of the capital gain from sale of the property.

As an additional integrity measure, up to 20 per cent of the income of the MIT may be derived from other eligible investment activities permitted under the existing tax law. If this 20 per cent threshold is breached in any income year, foreign investors will be subject to 30 per cent withholding tax on investment returns for that income year.

Resident individual investors will be able to take advantage of the increased CGT discount for affordable housing (see above), for eligible properties held via MITs. To access the increased discount, the property will only need to be held as affordable housing for three years rather than the ten years required for foreign residents to benefit from the 15 per cent withholding rate.

As noted above, the Government has indicated it will consult further on the implementation of this policy, including what property will qualify as "affordable" housing for the purposes of this measure and the increased CGT discount discussed above. The Government may also need to consider whether GST changes are required to allow input tax credits to be claimed for properties that are to be held for rental in order to support this policy initiative.

Annual charge on foreign owners of underutilised residential property

The Government has announced a "ghost house tax" for foreign investors who leave residential properties unoccupied or not genuinely available for rent for at least six months of each year. The charge, which will apply to foreign persons who make a foreign investment application for residential property from 7.30pm (AEST) on 9 May 2017, will be levied annually and will be equivalent to the relevant foreign investment application fee imposed on the property at the time it was acquired by the foreign investor. Treasurer Scott Morrison indicated in his Budget speech that this annual charge would be at least $5,000 per property.

No information has been provided as to how this new annual charge will interact with existing state based taxes. For example, the Victorian Government recently announced plans to impose a Vacant Residential Property Tax on dwellings that are vacant for more than a total of six months in a calendar year, from 1 January 2018.

Changes to foreign resident CGT regime

A number of changes have been announced to the foreign resident CGT regime. Foreign residents are broadly subject to CGT only on the disposal of taxable Australia property, which includes real property in Australia and indirect Australian real property interests. Broadly, a share in a company or an interest in a trust is an indirect Australian real property interest where the investor holds at least ten percent of the company or trust (known as the portfolio interest test) and real property in Australia comprises at least 50 per cent of the underlying assets in the company or trust (known as the principal asset test). The Government has indicated that it will amend these rules so that, with effect from 7.30pm (AEST) on 9 May 2017, the "principal asset test" will be applied on an associate inclusive basis.

There are also proposed amendments to the current foreign resident CGT withholding regime, which came into effect from 1 July 2016. Under the current regime, where a foreign resident disposes of certain taxable Australian property, the purchaser is required to withhold ten per cent of the purchase price and pay this amount to the Australian Taxation Office (ATO). The foreign resident vendor is then entitled to claim a credit in the tax return for the amount withheld. Certain transactions, including real property transactions with a market value under $2 million, are excluded.

From 1 July 2017, the withholding rate under this regime will be increased from 10 per cent to 12.5 per cent. In addition, from 1 July 2017 the threshold for exempt real property will be decreased from $2 million to $750,000.

Whilst the Government's aim is to reduce the risk that foreign residents avoid paying a CGT liability they owe in Australia, as a result of these proposed amendments, a much larger number of transactions will be potentially caught by this regime. Resident vendors are not unaffected by this regime - under the current law, a resident vendor is required to get a clearance certificate from the ATO confirming they are an Australian resident when they dispose of real property that would otherwise be subject to withholding. The original $2 million threshold for real

property was intended to carve out the majority of residential house sales. Assuming the current clearance certificate process remains in place, the proposed decrease to $750,000 will have a huge impact on residential housing sales going forward.

Denying access to the main residence exemption for foreign and temporary residents

The Government will amend the law to prevent foreign and temporary tax residents from claiming the main residence CGT exemption when they sell a property in Australia. This measure will apply from 7.30pm (AEST) on 9 May 2017. However under grandfathering rules, existing properties held prior to this time will remain eligible for the main residence exemption until 30 June 2019.

Helping first home buyers to save for a deposit

Referred to as the "first home super saver scheme", the Government will amend the superannuation law to allow first home buyers to withdraw future voluntary concessional and non-concessional contributions to superannuation for a first home deposit.

Under this proposed measure, from 1 July 2017, first home buyers can contribute up to $15,000 per year (and up to $30,000 in total) to superannuation, within the existing contribution caps (i.e. for concessional contributions, the cap is $25,000 per year from 1 July 2017). These amounts, plus associated earnings, can then be withdrawn from 1 July 2018. Withdrawals of concessional contributions will be taxed at marginal rates less a 30 per cent offset. When non-concessional amounts are withdrawn, they will not be taxed.

A couple can effectively double these limits by both taking advantage of the measure to buy their first home together. All first home buyers should be able to take advantage of this new measure, including those that are self-employed, due to the recent law amendments that will allow deductions for personal superannuation contributions from 1 July 2017.

Higher superannuation caps for downsizers

From 1 July 2018, the Government will allow a person aged 65 years or over to make a non-concessional contribution of up to $300,000 from the proceeds of selling their home.

These contributions 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 non-concessional contributions.

This measure will apply to the sale 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 house.

Denying deductions for travel expenses on residential rental property

From 1 July 2017, investors will no longer be able to claim tax deductions for travel expenses related to inspecting, maintaining or collecting rent on a residential rental property. This measure will affect all taxpayers - resident and non-residents - who receive assessable rental property income. Property management fees paid to third parties such as real estate agents will remain tax deductible.

Limiting depreciation for residential rental property

The Government has announced that it will limit depreciation deductions on plant and equipment (e.g. hot water systems or dishwashers) to outlays actually incurred by investors in residential real estate properties from 1 July 2017. This means that when an investor purchases residential property which includes items of depreciable plant and equipment, they will not be able to claim depreciation deductions. Instead the cost of items of existing plant and equipment will be reflected in the cost base for CGT purposes.

Existing investments will be grandfathered such that 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.

03

Financial services

Introduction of a Major Bank Levy

The Government has introduced a major bank levy on Authorised Deposit-taking Institutions (ADIs) which have licensed entity liabilities of at least $100 billion. The levy will apply from 1 July 2017.

The levy will be payable at a rate of 0.015 per cent per quarter on the specified liabilities of Australian banks where the qualifying liabilities of those banks exceed the threshold of $100 billion. The Treasurer has indicated that this levy will, in effect, apply only to the five largest Australian banks.

Liabilities subject to the levy will include items such as corporate bonds, commercial paper, certificates of deposit, and Tier 2 capital instruments. The levy will not apply to the additional Tier 1 capital and deposits of individuals, businesses and other entities protected by the Financial Claims Scheme. It is not immediately clear whether the calculation will be based on global or only Australian balances, and whether the financial statements or regulatory returns will be used as the foundation for the calculations. Many essential details will need to be clarified in order to fully understand the implications of the levy.

It is understood that the levy should be deductible to the banks, but this will need to be specifically confirmed.

The relevant Budget Papers also highlight that the Australian Competition and Consumer Commission will undertake a residential mortgage pricing enquiry until 30 June 2018 which will allow it to require banks to explain any changes or proposed changes they make to their interest rates and other fees.

Relevantly, the United Kingdom (UK) introduced a bank levy in 2011. The levy rate was increased several times since it was first introduced, and recently a staggered reduction in the rate over the period to 2021 was announced (the UK levy is currently 0.17 per cent and will reduce to 0.1 per cent by 2021,with those rates halved in respect of long-term liabilities/equity). In the UK, the calculation of the balances to which the bank levy attaches has been complicated to say the least, requiring in-depth reconciliations and extensive industry consultation to get the detail right. No doubt those UK experiences will be relevant as the Australian version is developed.

04

Global taxes

Building on already strong anti-avoidance and integrity rules within the existing tax framework, Australia continues to pursue measures aimed at addressing perceived tax avoidance by multinational corporations (MNCs).

In addition to the measures discussed below, the Government has also announced changes to the foreign resident Capital Gains Tax (CGT) regime (including the relatively new foreign resident CGT withholding regime) as part of its housing affordability package. These proposed changes will, however, have wider ramifications. Refer to *Housing tax measures* for further details.

Application of the hybrid mismatch rules to regulatory capital

The Government announced in last year's Federal Budget that it plans to implement the majority of the recommendations from the Organisation of Economic Cooperation and Development's (OECD) work on eliminating hybrid mismatches with effect from the later of 1 January 2018 or six months after the relevant law is enacted. No further announcement was made in relation to the timing of these measures in this year's Federal Budget.

In this year's Federal Budget, the Government has announced that it will address hybrid tax mismatches that occur in cross-border transactions relating to regulatory capital known as Additional Tier 1 (AT1) by:

- preventing returns on AT1 capital from carrying franking credits where such returns are tax deductible in a foreign jurisdiction, and
- where the AT1 capital is not wholly used in the offshore operations of the issuer, requiring the franking account of the issuer to be debited as if the returns were to be franked.

The measure will apply to returns on AT1 instruments paid from the later of 1 January 2018 or six months after the law is enacted.

Transitional arrangements will apply to AT1 instruments issued before 8 May 2017 such that the measure will not apply to returns paid before the next call date of the instrument occurring after 8 May 2017.

Multinational Anti-avoidance Law

The Multinational Anti-Avoidance Legislation (MAAL), which took effect in Australia from 1 January 2016 targets, in broad terms, certain arrangements designed to avoid a taxable presence in Australia. Originally intended to affect 30 unnamed multinational corporations (MNCs), the MAAL cast a much wider net than expected, affecting a large number of MNCs.

In the 2017-18 Federal Budget, the Government announced that it will extend the scope of the MAAL so that it will apply to:

- corporate structures that involve the interposition of partnerships that have any foreign resident partners
- trusts that have any foreign resident trustees, and
- foreign trusts that temporarily have their central management and control in Australia.

This measure, intended to ensure the integrity of the original policy intent, will apply from 1 January 2016.

05

Private business

Although not a specific focus of this year's Federal Budget, there are a number of measures that were announced that will impact private business taxpayers:

Changes to the small business capital gains tax (CGT) concessions

The Government has announced from 1 July 2017 that it will limit access to small business CGT concessions to ensure that they can only be accessed in relation to assets used in a small business or ownership interests in a small business. Limited information is currently available in relation to this measure however it appears to be targeted at the application of the maximum net asset value test and the small business entity eligibility requirements.

Extension of immediate $20,000 write-off of depreciable assets

The Government will extend the immediate deductibility of assets costing less than $20,000 for small business entities (i.e. those with aggregated annual turnover of less than $10 million) which was due to expire on 30 June 2017 by a further 12 months to 30 June 2018. The measure will provide additional time for small business to access this concession, providing significant incentives for many businesses to increase their current capital expenditure spend. However, the after-tax consequences of the proposed immediate deduction for depreciating assets should be considered. For example, if this results in a tax loss, there is no immediate cash-flow advantage.

It is also worth noting that the Federal Government has made good progress in implementing the reforms announced in last year's Federal Budget that specifically affect small to medium businesses and start up ventures.

Of particular note, the legislation to progressively reduce the corporate tax rate for companies with aggregated turnover of less than $50 million and to increase the small business aggregated turnover threshold to $10 million for certain concessions (including the instant asset write-off, but not the small business CGT concessions) is now ready to be enacted to clear the way for small to medium business taxpayers to be able to reap the full benefits of tax savings.

06

Personal taxes

While individual taxpayers were spared from any direct tax increases in the 2016-17 Federal Budget, all taxpayers – resident and non-residents – will be impacted by a range of measures in this year's Federal Budget.

As expected, the Temporary Budget Repair levy which is due to expire on 30 June 2017 was not extended. Instead, the Government has announced an increase of the Medicare levy (from 2 per cent to 2.5 per cent) from 1 July 2019.

With regards to housing, the Government chose to maintain the pressure on foreign investors in order to boost affordable housing for Australians. Some of these measures are applicable from 9 May 2017.

Other tax rates and levies such as income tax rates or Medicare levy surcharge remain unchanged.

Income tax rates

No changes were announced in the Federal Budget in relation to personal income rates.

Personal income tax rates for the 2017-18 year will therefore remain the same as for the 2016-17 year (see table below).

Table 1: Tax rates for 2017-18 income year

Taxable income threshold range ($)	Resident individual 2017-18 marginal income tax rate (%)	Non-resident individual 2017-18 marginal income tax rate (%)
0 – 18,200	0	32.5
18,201 – 37,000	19	32.5
37,001 – 87,000	32.5	32.5
87,001 – 180,000	37	37
180,001 +	45	45

Temporary Budget Repair levy will expire

The Temporary Budget Repair levy of 2 per cent of taxable income in excess of $180,000 will automatically expire on 30 June 2017 under law that is currently in place. The Government has made no changes in this year's Budget to extend the Temporary Budget Repair levy. Therefore, excluding the impact of the Medicare levy, from 1 July 2017, the top marginal tax income tax rate will be 45 per cent.

Increase of the Medicare levy

The Government has announced that the Medicare levy will increase from 2 per cent to 2.5 per cent from 1 July 2019. Other tax rates that are linked to the top personal tax rate, such as the fringe benefits tax rate, will also increase.

For the 2017-18 year, the Medicare levy rate will remain at 2 per cent of taxable income.

The Medicare levy low-income thresholds for singles, families and seniors and pensioners will increase. The increased thresholds for the 2017-18 year are:

- Individuals $21,655 (increased from $21,335)
- Families $36,541 (increased from $36,001), with an additional $3,356 for each dependent child or student (increased from $3,306)
- Single seniors and pensioners $34,244 (increased from $33,738), and
- The family threshold for seniors and pensioners will be increased to $47,670 (increased from $46,966) plus $3,356 for each dependent child or student (increased from $3,306).

Private health insurance and Medicare levy surcharge

Although there has been no announced change to the Private Health Insurance Rebate and Medicare levy surcharge, it is worth noting that the private health insurance rebate percentage is indexed annually at 1 April.

The current private health insurance rebate entitlements and surcharge applicable to individuals who do not have the appropriate health insurance hospital cover, from 1 April 2017 to 31 March 2018 are as follows.

Table 2: Private health insurance rebate entitlements and Medicare levy surcharge from 1 April 2017 to 31 March 2018

	Full entitlement	Tier 1	Tier 2	Tier 3
Taxable income				
Singles	$90,000 or less	$90,001 – $105,000	$105,001 – $140,000	> $140,000
Families	$180,000 or less	$180,001 – $210,000	$210,001 – $280,000	> $280,000
Rebate				
Aged under 65 years	25.934%	17.289%	8.644%	0%
Aged 65 – 69 years	30.256%	21.612%	12.966%	0%
Aged 70 or over	34.579%	25.934%	17.289%	0%
Medicare Levy surcharge				
All ages	0.0%	1.0%	1.25%	1.5%

Note: For families with children, the thresholds are increased by $1,500 for each child after the first.

Housing affordability

The Government also made announcements in order to reduce pressure on affordability of housing for Australians.

Various measures will affect foreign individuals with regards to Capital Gains Tax (CGT) such as:

- CGT main residence exemption is no longer available from 7.30pm (AEST) on 9 May 2017 for foreign and temporary tax residents, subject to grandfathering provisions for existing properties.
- CGT withholding tax rate on sales by foreign tax residents increased from 10 per cent to 12.5 per cent from 1 July 2017.
- CGT withholding threshold for sales by foreign tax residents decreased from $2 million to $750,000 from 1 July 2017.
- A new charge on vacant property owned by foreign persons who do not live in the property and do not rent it out or have it genuinely available for rent for at least six month per year. This change will apply to foreign persons who make a foreign investment application for residential property from 7.30pm (AEST) on 9 May 2017.

In addition, the Government will increase the CGT discount for Australian resident individual taxpayers who invest in affordable housing. From 1 January 2018, such investors will be entitled to a 60 per cent discount.

More details and other measures affecting housing can be found in the ***Housing tax measures*** section.

07

Superannuation

After the raft of changes announced in last year's Federal Budget applicable from 1 July 2017, limited superannuation changes have been included in this year's Federal Budget.

Superannuation and housing affordability

Two superannuation measures have been included as part of the housing affordability package, namely:

- Voluntary concessional contributions, as well as non-concessional contributions, to superannuation made by first home buyers from 1 July 2017 may be withdrawn for a first home deposit, along with associated deemed earnings.
- From 1 July 2018, a person aged 65 or over will be able to make a non-concessional contribution of up to $300,000 from the proceeds of selling their home. These contributions will not be subject to any age or work tests and will be in addition to any other voluntary contributions made under existing contribution rules.

See our *Housing tax measures* section for further discussion.

Integrity measures

The following integrity measures have been also been announced which are intended to ensure that the 2016-17 superannuation reform package operates as intended:

- From 1 July 2017 limited recourse borrowing arrangements (LRBA) will be included in a member's total superannuation balance and transfer balance cap. Exposure Draft legislation was released on 27 April 2017 that seeks to ensure that the outstanding balance of a LRBA will now 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.
- From 1 July 2018, members will have reduced opportunities to use related party transactions on non-commercial terms to increase superannuation savings. The existing 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 a transaction is on a commercial basis.

Extending tax relief for merging of superannuation funds

The Government has announced an extension of the existing loss relief and asset rollover for merging superannuation funds until 1 July 2020. This measure will be widely welcomed by superannuation funds that are currently in the process of, or considering, merging. The current relief, which has been in place since 1 October 2011 (although even this was an extension of a prior measure dating back to 2008), is due to expire on 1 July 2017.

It is somewhat disappointing that the Government has not seen fit to make this relief a permanent feature, and has only extended it for another three years, as it is likely that the consolidation of superannuation funds will continue indefinitely as the super fund industry grows and changes over time.

08

Indirect tax

Goods and services tax

Improving the integrity of the Goods and Services Tax (GST) on property transactions

As part of its tax integrity package, the Government will improve the integrity of the 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 Australian Taxation Office (ATO) as part of settlement. By changing the compliance obligations, this measure will significantly alter the way in which the ATO collects the required GST.

Removing the double taxation of digital currency

The Government has confirmed its commitment to remove double taxation of digital currency, such as Bitcoin. From 1 July 2017, the GST treatment of digital currency will align with that of money i.e. purchases of digital currency will no longer be subject to the GST. Currently, consumers can be subject to the GST on the purchase of digital currency and again on its use in exchange for other goods and services (which are also subject to the GST).

GST distribution to the States and Territories

In the lead up to the Federal Budget, the Treasurer has asked the Productivity Commission to undertake an inquiry into the impact on our economy of Australia's system of horizontal fiscal equalization (HFE), which underpins the distribution of the GST revenue to the States and Territories.

Under Australia's current approach to HFE, which was agreed to by all States and Territories prior to the introduction of the GST in 2000, the Commonwealth Grants Commission recommends a GST distribution that provides each State with the capacity to provide its citizens with a comparable level of government services.

The inquiry is expected to consider the influence the current system has on productivity, efficiency and economic growth, including the movement of capital and labour across state borders; the incentives for the States to undertake fiscal (expense and revenue) reforms that improve the operation of their own jurisdictions, and on their abilities to prepare and deliver annual budgets.

Following a period of public consultation, the Productivity Commission is due to report to Federal Government by 31 January 2018.

Other key indirect tax measures

Tobacco taxation

The Government will adjust the taxation treatment of roll your own (RYO) tobacco and other products such as cigars so that manufactured cigarettes and RYO tobacco cigarettes receive comparable tax treatment. This adjustment will be phased in over four years from 2017 to 2020 to match the timing of the previously legislated tobacco tax increases which occur on 1 September each year.

History has shown that any increase in the significance of these products as revenue items has triggered increased scrutiny and supply chain security focus by Australian Border Force and related agencies. This suggests that importers of tobacco products can expect more targeted reviews of their imports.

Duty relief for high tech manufacture

As part of a range of measures to promote high technology manufacturing businesses, customs duty relief will be extended to motor vehicle producers for the importation of prototype vehicles and components to automotive service providers. Businesses relying on this concession when importing these goods should carefully review eligibility criteria relating to prototypes.

Technology in trade

Significantly, there is a clear signal that the Federal Government will invest heavily in a range of technologies aimed at establishing a single data entry point that will limit duplication across a range of agencies.

Whilst not limited to trade, there are clear indications of a digital transformation that reflects the establishment of a single window for trade and other government data, improving efficiency for business while simultaneously accelerating opportunities for data analytics and risk management as part of the security focus of the current Federal Budget. It will be critical that industry engages with Government to ensure that the needs of business are understood and incorporated in policy implementation.

Strengthening food safety and assurance

There are key initiatives that emphasise the requirement for some of the largest Australian companies to control and monitor both supply chain integrity and quality control at source. This includes specific measures to extend the power of Federal Government agencies to detain imports at the border, together with specific requirements in the livestock industry to ensure enhanced track and trace capability for outbound trade which supports domestic and international standards on live exports.

09

Other tax measures

Increase in Fringe Benefits Tax rate

As noted in the Personal Taxes section, due to the increase in the Medicare levy to 2.5 per cent from 1 July 2019, the Fringe Benefits Tax (FBT) rate will also be increased in line with the top individual marginal tax rate (plus Medicare levy).

Accordingly, the rate of FBT is expected to be set at 47.5 per cent. As the Federal Budget papers do not indicate a start date for any FBT rate change, we would expect it to operate from the commencement of the FBT year commencing 1 April 2020 (at the latest). A corresponding increase in the gross-up rate will be required for calculating the taxable value of fringe benefits.

Targeting organised tax crime

An additional $28.2 million will be provided to the Australian Taxation Office (ATO) to target organised crime. Although limited details are available, this looks to be an extension of measures announced in previous Federal Budgets to use cross-agency collaboration to counter crime and tax evasion.

Recommendations from the Black Economy Taskforce

The interim report of the Black Economy Taskforce, which was established in December 2016, was released as part of the Federal Budget. Three recommendations from the interim report were accepted by the Government for immediate action and announced in the 2017-18 Federal Budget:

- The taxable payments reporting system will be extended to the courier and cleaning industries from 1 July 2018 with the first annual report required to be lodged by August 2019.
- A further $32 million will be provided to the ATO for one year of additional funding to target black economy risks including non-lodgment, income omission and non-payment of employer obligations.
- A prohibition will be enforced on the use, manufacture or distribution of technology and software that deletes records from electronic point of sale.

10

Forward tax agenda

To round out this year's commentary on the tax and superannuation measures announced in the 2017-18 Federal Budget, we have highlighted below the current status of previously announced tax measures. But first, where are we up to with tax reform in Australia?

The last decade or so has seen a number of attempts at large scale tax reform in Australia which have failed to achieve the necessary consensus across all sides of politics to succeed. It seems that in place of much needed wholesale tax reform, the Government is targeting discrete areas of change to taxation, such as integrity measures for multinationals and a reduction in the company tax rate.

While it might be said that substantive tax reform is currently 'too hard' to achieve in Australia, we should not give up on the challenge to create a tax system that sets Australia up for future growth and prosperity. This is even more relevant in times when tax reforms are being undertaken in many other jurisdictions (the United States most recently formally embarking on a plan for comprehensive reforms to its tax system).

Australia as a nation needs to look at the sustainability of the current tax system over the medium to longer term. Many of the revenue measures announced in the 2017-18 Federal Budget are one-offs and do not address underlying structural issues.

A lower corporate tax rate

Following the release in April 2017 of the Trump Administration's high level principles for tax reform in the United States (which, significantly, included a target corporate tax rate of 15 per cent), the Government has renewed its commitment to lowering the corporate tax rate in Australia to 25 per cent for all companies over the next ten years as first announced in last year's Federal Budget.

The Government's plan to pursue the full corporate tax rate reduction package builds on its recent success in passing through Parliament a phased-in reduction to the corporate tax rate for companies that carry on a business with aggregated turnover of up to $50 million.

Although a corporate tax rate reduction for smaller companies is a step in the right direction, the biggest economic benefits will be achieved when Australia has lower income tax rates applicable to all businesses. Australia needs to reduce tax costs to not only attract foreign investment, but to promote economic growth and encourage investment and drive improvements in real wages. Global tax competition is a real and fundamental challenge to Australia's ability to attract international investment and the base line corporate tax rate is a key benchmark.

Only time will tell if the Government can deliver on a promise of broader corporate tax rate cuts with the current composition of Parliament.

Status of other outstanding measures

In the lead up to the Federal Budget, the Government surprised us by indicating that its responses to the following critical issues would be considered outside of this Budget:

- reform to the Petroleum Resource Rent Tax, and
- tax treatment of stapled arrangements.

Furthermore, we are still waiting on the Government's response to last year's Research and Development (R&D) Tax Incentive Review conducted by Chair of Innovation Australia Bill Ferris, Australia's Chief Scientist Alan Finkel, and Secretary to the Treasury John Fraser. The Review made a number of recommendations to improve the effectiveness and integrity of the programme, achieve a stronger focus on additionality and ensure that the current program is better targeted.

Although the Government has made some good progress in implementing many of its prior year announcements affecting taxation matters, there remains once again a backlog of measures which still need to be dealt with and introduced into Parliament. This list has grown significantly since the Government reviewed a backlog of announced but unenacted tax measures in 2013 to "restore integrity in the Australian tax system". It is pleasing to see additional funding allocated to Treasury and the Office of Parliamentary Counsel in this year's Federal Budget to ensure dedicated drafting resources are available to progress "taxation reform legislation".

Table 3: Key measures announced not yet introduced to Parliament

Measure	Status
Amendments to the tax consolidation regime	There are a number of proposed amendments to the tax consolidation regime that remain outstanding, including the treatment of deductible liabilities in the tax cost setting process. These amendments have been outstanding for many years and some of these outstanding amendments have retrospective start dates back to the commencement of the Taxation of Financial Arrangements (TOFA) regime (in most cases, income years commencing on or after 1 July 2010), or for arrangements that commenced on or after 14 May 2013. The revised deductible liability measure is proposed to apply from 1 July 2016.
Reform of the Taxation of Financial Arrangements (TOFA) regime	Major reforms to the TOFA rules are intended to reduce their scope, decrease compliance costs and increase certainty through the redesign to the TOFA framework. The new simplified rules are proposed to apply to income years commencing on or after 1 January 2018.
Implementation of anti-hybrid rules	The Government will seek to implement the anti-hybrid rules developed by the Organisation for Economic Cooperation and Development (OECD) with some minor modifications as recommended by the Board of Taxation in its report to the Government. The anti-hybrid rules are proposed to apply to payments made on or after the latter of 1 January 2018 and six months after enactment of the relevant law. This is now to be supplemented with the additional measure announced in the 2017-18 Federal Budget applicable to regulatory capital (see Global Taxes).

Measure	Status
Limiting the scope of the integrity provisions in the debt / equity rules	The Government released draft legislation to implement the Board of Taxation's recommendations approach to improve the debt and equity tax rules. The new rules, once enacted, will replace the existing related scheme rules and repeal the equity override integrity provision, in relation to transactions entered into after the commencement of the law which will be a day to be fixed by proclamation (or if there is no proclamation, six months after Royal Assent).
Removing barriers to the use of asset backed financing	Key barriers to the use of asset-backed financing arrangements (that is, financing arrangements which are supported by assets such as deferred payment arrangements and hire purchase arrangements) are to be removed with effect from 1 July 2018.
Private company deemed dividends	From 1 July 2018, the operation and administration of the private company deemed dividends rules (Division 7A of the Income Tax Assessment Act 1936) are to be reformed so as to be clearer and assist in easing the compliance burden while maintaining the overall integrity and policy intent of Division 7A.
Wine Equalisation Tax (WET)	The Government has released draft legislation on proposed changes to the WET to address integrity concerns. These changes include a reduction in the WET rebate cap and tighter eligibility criteria from 1 July 2018.
New Collective Investment Vehicles (CIVs)	To complement the commencement of the Asia Region Funds Passport, the Government will introduce two new types of CIVs - a corporate CIV and limited partnership CIV, both of which will have flow through status for tax purposes. The corporate CIV is proposed to be available for income years starting on or after 1 July 2017, with the limited partnership CIV to follow one year later.
CIV non-resident withholding taxes	The Government indicated last year that it would consider non-resident withholding taxes on CIVs in the 2016-17 financial year. A consultation paper was released in November 2016.
Protection for tax whistleblowers	From 1 July 2018, new measures will be introduced to better protect individuals (including employees, former employees and advisers) who disclose information to the ATO on tax avoidance behaviour and other tax issues. A consultation paper was released in December 2016.
Mandatory disclosure of aggressive tax arrangements	In May 2016 the Government released a consultation paper seeking community input on the adoption of the OECD's mandatory disclosure rules for aggressive tax arrangements in Australia. Broadly, these will require tax advisers and/or taxpayers to make early disclosures of aggressive tax arrangements (often before income tax returns are lodged), to provide tax authorities with timely information on arrangements that have the potential to undermine the integrity of the income tax system.
Preventing franked distributions funded by capital raisings	A specific measure will be introduced to prevent franking credits being attached to a distribution declared by a company to its shareholders outside or additional to the company's normal dividend cycle, to the extent it is funded directly or indirectly by capital raising activities which result in the issue of new equity interests. This measure will apply to distributions made after 12:00pm (AEDT) on 19 December 2016.
Improving the transparency of tax debts	From 1 July 2017, the ATO will be permitted to disclose certain tax debts to credit reporting bureaus where a taxpayer has not effectively engaged with the ATO to manage their outstanding debts. This measure will initially only apply to businesses with an Australian Business Number and tax debt of more than $10,000 that is at least 90 days overdue.

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