2016-17 Australian Federal Budget

Cut to company tax rate from 30% to **25%** phased over 10 years

12.5%

Tobacco excise tax to increase 12.5% per year over next 4 years

$2.9bn

extra in health funding

Small business instant asset write-off extended

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Contents

01

Introduction

Prime Minister Malcolm Turnbull is fond of declaring “there has never been a more exciting time to be an Australian”.

And Treasurer Scott Morrison has followed suit with his own superlative, challenging that the 2016-17 budget cannot be “just another budget, because these are extraordinary times.”

So, does the 2016-17 Budget live up to the hype?

For all the pre-budget talk of uncertainty and volatility in the global economy, Treasury is projecting a remarkably stable macroeconomic picture – the economy growing at a healthy three per cent from 2017-18, unemployment a benign five and a half per cent, and inflation well inside the RBA’s comfort zone. Hardly extraordinary.

The Treasurer mentions China just once in the budget speech. Only in the detailed budget papers is there caution as to the extent to which our economy is tied to the economic fortunes of our now largest trading partner and growing source of foreign investment capital. Indeed, there seems to be a newfound bullishness in the world economy, with prices for key exports rebounding strongly from the December Mid-Year Economic and Fiscal Outlook – iron ore export prices from $US39/t to $US55/t, and metallurgical coal from $US73/t to $US91/t.

Treasury fundamentally is relying on solid economic growth to bring the budget back into line, even if a surplus is now not expected until at least 2020-21.

Notwithstanding the Treasurer’s crediting this fiscal improvement on policies that “continue to control spending”, the real budget hero is tax revenues.

The Federal Government’s tax revenues are forecast to increase from 23.5 per cent of GDP in 2015-16 to 25.1 per cent of GDP by 2019-20. Federal Government expenditures do contract, but by a comparatively modest 25.8 per cent to 25.2 per cent of GDP.

Over the four year period to 2019-20 the Federal Government’s nominal tax receipts will swell by almost 30 per cent. Treasury is forecasting that tax receipts will top $500 billion by 2019-20 – that’s half a *trillion dollars*. And to get there the Federal Government will need to collect each year an additional $28 billion, equivalent to around 40 per cent of what it currently collects in company and resource rent taxes.

To be fair, it isn’t just growth doing the heavy lifting. The 2016-17 Budget did introduce a number of significant tax policy changes, but well short of the hoped-for comprehensive tax reform package.

The corporate tax rate cut is a start, but needs to be complemented by a broader structural reform of taxation that makes our tax base more stable and does not penalise growth, investment or incentives. While the politics of an extended phase in and prioritisation of small business is understandable, these constraints dampen the scale and pace of any economic dividend.

If the economy is to buzz at the rate required to meet Treasury's projections, startups and small and medium businesses must accept the growth challenge. The economy needs small business to fire, and to fire fast.

The small adjustment to the $80,000 tax bracket for individuals is a cost-effective first step but is only a stop-gap measure.

The 2016 budget also included a range of tax "integrity" measures aimed at larger and multinational corporates. Australia has a heavy reliance on foreign capital, and needs a competitive tax system to remain an attractive place to invest and do businesses. However, corporate Australia does need to work to build trust with the community, and committing to transparency measures will help tackle the public perception that some parts of the economy are not paying their fair share of tax.

There also were significant changes to superannuation policy, targeted squarely on higher-income earners. Perhaps stung by the criticism in recent budgets that savings efforts have unfairly fallen on lower income earners, the Treasurer has been at pains to point out that 96 per cent of the population will be better off or not affected by the proposed changes to superannuation, and that those affected are the most well off in the community.

Corporate Tax

Pathway to a lower corporate tax rate

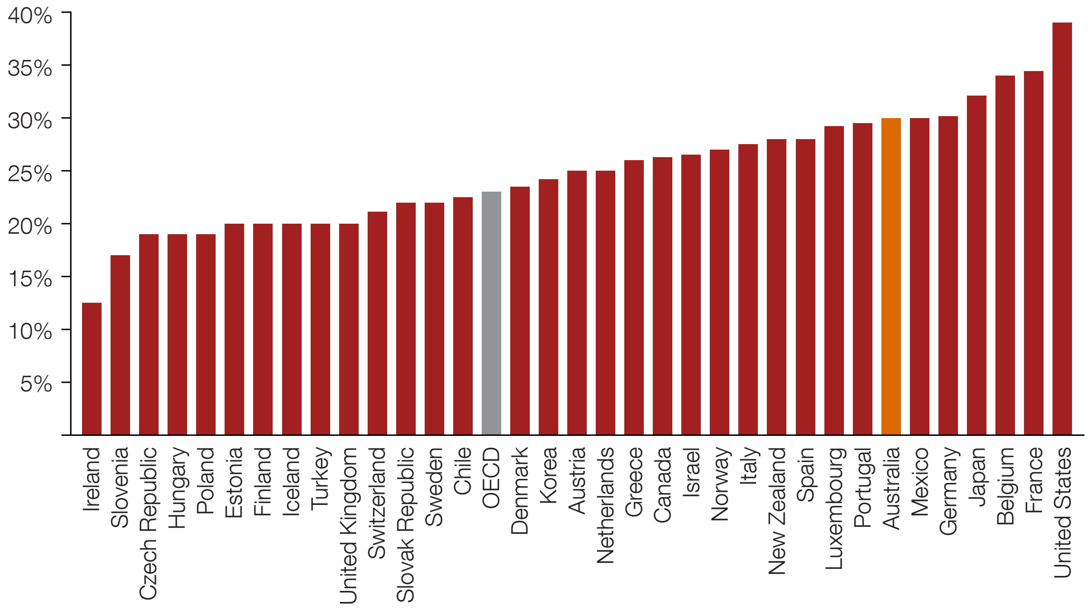
In a move that will be welcomed by the business community, as part of this year's Federal Budget the Government has set out the path for lowering the corporate tax rate to 25 per cent for all companies over the next 10 years. The corporate tax rate is currently 28.5 per cent for small business entities (broadly, those with annual aggregated turnover of less than $2 million) and 30 per cent for all other companies.

The rate cut will commence with a reduction for small business companies (being those with annual aggregated turnover of up to $10 million) to 27.5 per cent from the 2016-17 income year. The annual aggregated threshold will then be progressively increased to ultimately have all companies taxed at the rate of 27.5 per cent in the 2023-24 income year. Refer to the *Private Business* section for further details of this phasing.

From the 2024-25 income year the tax rate will be reduced for all companies to 27 per cent and then be reduced progressively by 1 percentage point per year until it reaches 25 per cent in the 2026-27 income year.

These rate reductions will apply to all companies (both resident and non-resident) and to other entities taxed like companies (for example, public trading trusts and limited partnerships). As noted above, it is the Government's intention to align the small business and general corporate tax rates going forward, which will have the additional benefit of removing the complexity of the current tiered tax rate system which can act as a deterrent to growth. Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution.

Corporate income tax rates in the OECD



Source: The Organisation for Economic Co-operation and Development (OECD) – https://stats.oecd.org/Index.aspx?DataSetCode=TABLE_II1

The Government has indicated that lowering the corporate tax rate is part of its overarching plans to promote economic growth in Australia and encourage investment by making Australia's corporate tax rate more competitive. At least some part of the 'trade-off' for lowering the corporate tax rate would appear to be a range of new anti-avoidance measures targeting multinational corporations. Refer to the *Global Tax* section for further details.

At 30 per cent, Australia's corporate tax rate is well above the 23 per cent average for Organisation of Economic Cooperation and Development (OECD) member states. In the past 15 years, Australia's headline corporate tax rate has remained constant while there has been a clear global trend to reduce corporate tax rates. As the competition for highly mobile capital increases, a high corporate tax rate can act as a significant roadblock for investment into Australia. It can also impact on domestic investment and reduce the incentive to innovate, and in turn, have the consequences of reducing economic growth, productivity and real-per-person incomes.

PwC supports the lowering of the corporate tax rate. While the Government's phased-in approach is a sensible means of achieving the benefits of a lower corporate tax rate in Australia having regard to the current Budgetary restraints, this dampens the scale and pace of any economic dividend. The case for lowering the corporate tax rate is set out in detail in out Protecting Our Prosperity publication, *A Corporate Rate Reduction: the case for and against*.

Tax consolidation

For three years, corporate groups undertaking transactions involving the acquisition or disposal of another entity have had to model the tax consolidation outcomes having regard to the current law as enacted, as well as the proposed laws that were to apply to arrangements commencing on or after 14 May 2013.

Some level of relief will be achieved in respect of the proposed 'deductible liabilities' measures, with new rules announced in this year's Federal Budget applying from 1 July 2016, rather than arrangements commencing on or after 14 May 2013. The 2013 announcement had been widely criticised as creating a market-distorting tax impost for ordinary corporate mergers & acquisitions.

In a welcome amendment, head companies of consolidated groups will no longer be required to bring to account assessable income amounts corresponding to the deductible liabilities of a joining entity. Instead, when calculating the allocable cost amount (ACA) of the joining entity, deductible liabilities will be excluded. As a result, the assets of the acquired entity will have a lower tax cost base which may reduce future tax depreciation deductions. However, in a business which is rich with intangible assets for which there are no tax deductions (e.g. customer relationships and goodwill) this may not have a material tax cost outcome. The Budget announcement promises the new rules will be much simpler than those previously proposed. This is promising, but may mean that the new rules will apply in a broader range of circumstances, with limited or no carve outs for group formations or certain group restructures.

The current treatment of deferred tax liabilities (DTLs) on entry to, and exit from, a consolidated group gives rise to complex calculations and uncertain outcomes. This year's Budget includes an announcement that for transactions commencing after the date the amending legislation is introduced into Parliament, DTLs will be excluded from the ACA entry and exit calculations. This change will reduce the complexity involved in the joining and leaving process.

The 2014-15 Federal Budget included proposed amendments applicable to accounting liabilities in respect of securitised assets. Because the liability exists for accounting purposes, but the asset is not recognised for tax purposes, an unintended result could arise when an entity joins or leaves a consolidated or MEC group. The original proposal, which is to apply to arrangements commencing on or after 7.30pm (AEST) 13 May 2014, only applies where a member of the group is an authorised deposit taking institution (ADI) or a financial entity. The 2016-17 Federal Budget extends this 'securitisation measure' to non-financial institutions for arrangements commencing on or after 7.30 pm (AEST) 3 May 2016.

In addition to the above measures, there remain some major tax consolidations amendments that have been announced in previous year's budgets and are yet to be enacted. These are set out in the table below.

Previously announced measure	Date of effect
Non-residents will not be able to buy and sell membership interests between consolidated groups to allow the same ultimate owner 'to claim double deductions' through the resetting of the tax cost of the assets without any recognition under the non-resident capital gains tax (CGT) rules (referred to as the 'churning' measure)	Arrangements that commenced on or after 14 May 2013
Consolidated groups will not be able to access double deductions by shifting the value of assets between entities, i.e. when an encumbered asset, whose market value has been reduced due to the intra-group creation of rights over the encumbered asset, is sold by a consolidated group (referred to as the 'value shifting' measure)	Arrangements that commenced on or after 14 May 2013
Only net gains and losses on certain intra-group liabilities and assets that are subject to the taxation of financial arrangements (TOFA) regime will be recognised for tax purposes upon exit of a member from a consolidated group (referred to as the 'TOFA measure')	Applies from the commencement of the TOFA regime (in most cases, income years commencing on or after 1 July 2010)

03

Global Tax

Tax paid by multinational corporations (MNCs) continues to be a highly emotive and political issue in Australia. Over the past few years, the debate surrounding this issue in Australia triggered an inquiry by the Senate Economics Committee into ‘corporate tax avoidance’ which issued its most recent report on 22 April 2016 after 20 months of work (including 127 submissions and seven days of public hearings) with no doubt more to come. The tax measures announced by the Government as part of the 2016-17 Federal Budget continue the trend of recent years, both locally and globally, to target perceived “base erosion and profit shifting” (BEPS) by MNCs.

Diverted Profits Tax

The Government has announced a 40 per cent “diverted profits tax” (DPT) to apply to income years commencing on or after 1 July 2017. This measure is intended to ensure MNCs pay “an appropriate amount of tax on profits made in Australia” and provide greater powers to the Australian Taxation Office (ATO) for taxpayers “who do not co-operate with the ATO”. The DPT is intended to be based on the insufficient economic substance aspect of the DPT which has applied in the United Kingdom since 1 April 2015.

Background

The Organisation for Economic Co-operation and Development (OECD)/ G20 BEPS project was largely finalised in October 2015. The broad objective of this project was to reform the global tax rules on a multi-lateral basis. However, in the meantime, numerous countries have taken unilateral action (for example, the UK's DPT).

In last year's Federal Budget, the Government announced the introduction of the so-called Multinational Anti-Avoidance Legislation (MAAL) which took effect in Australia from 1 January 2016. The MAAL was largely modelled on the 'avoided permanent establishment (PE)' aspect of the UK DPT legislation. When originally announced, the Treasurer indicated that the MAAL was likely to affect 30 MNCs. However, the ATO has more recently indicated that around 176 companies have been contacted in relation to the MAAL. The ATO has also highlighted their concerns regarding certain restructuring designed to avoid the MAAL despite the clear expectation of the legislature that taxpayers would restructure their affairs to avoid the penal consequences of the MAAL.

The Government has released a 20 page DPT consultation paper seeking comments by 17 June 2016.

According to the Budget papers, the MAAL and DPT are expected to raise $650 million over four years.

Key features

It is proposed that the Australian DPT would:

- Apply to income years commencing on or after 1 July 2017, whether or not the relevant transactions were entered into before that date
- Apply only to significant global entities (i.e. those groups with global income of $1 billion or more) and an exclusion is proposed for circumstances where the Australian operations are relatively small (Australian group turnover of less than $25 million)
- Impose a penalty rate of tax (40 per cent) on profits transferred offshore through related party transactions with insufficient economic substance that reduce the tax paid on the profit by 20 per cent or more (i.e. in effect suffer a tax rate of less than 24 per cent)
- Apply where it is "reasonable to conclude" based on information available to the ATO that the arrangement is designed to secure a tax reduction
- Provide the ATO with wider powers to reconstruct an alternative arrangement on which to assess the diverted profits where the related party transaction is assessed to be artificial or contrived
- Require upfront payment of any DPT liability which can only be adjusted following a successful review of the initial assessment
- Put the onus on taxpayers to provide relevant and timely information on offshore related party transactions to the ATO to prove why the DPT should not apply.

Unlike income tax, the DPT would not operate on a self-assessment basis. A liability would only arise if an assessment is issued by the ATO.

Transactions subject to DPT

In broad terms, the proposed rules are based on the 'insufficient economic substance' aspect of the UK DPT. Specifically, if a taxpayer falls within the initial scope requirements of the DPT, two further requirements need to be met:

- The transaction(s) has given rise to an "effective tax mismatch"; and
- The transaction(s) has "insufficient economic substance".

Effective tax mismatch

An effective tax mismatch will exist where an Australian taxpayer (Company A) enters into a cross-border transaction, or series of cross-border transactions, with an associate (Company B) and, as a result, the tax liability of Company B attributable to the transaction is less than 80 per cent of the corresponding reduction in Company A's tax liability. For example, Company A claims a $100 reduction to its Australian tax liability from claiming a deduction for the payment, but due to the lower tax rate in Company B's jurisdiction, Company B only recognises a $60 increase in its tax liability from the corresponding receipt. As the assessable income for Company B in its home jurisdiction is less than $80, an effective tax mismatch will arise.

In determining the effective tax mismatch, all income taxes relevant to the transaction (both in Australia and in the foreign jurisdiction) will be taken into account.

Insufficient economic substance

The determination of whether there is insufficient economic substance will be based on whether it is "reasonable to conclude", based on the information available at the time to the ATO, that the transaction(s) was designed to secure the tax reduction. However, where the non-tax financial benefits of the arrangement exceed the financial benefit of the tax reduction, the arrangement will be taken to have sufficient economic substance.

Calculation of the DPT assessment and DPT tax payable

If the related party arrangement gives rise to an effective tax mismatch and has insufficient economic substance, the ATO may issue a DPT assessment. This assessment will be based on the total of the Diverted Profits Amount and the DPT rate (40 per cent and set to "encourage taxpayers to comply with Australia's transfer pricing rules").

In the case of a deduction considered to exceed the arm's length amount, the Diverted Profits Amount will be 30 per cent of the deduction. For all other cases, the Diverted Profits Amount will be based on the best estimate of the diverted profits that can reasonably be made by the ATO at the time.

In calculating the DPT tax payable, an offset will be available for (Australian and foreign) taxes payable on the diverted profits. An interest charge will be added.

Administrative process

Unlike income tax, the DPT will not be a self-assessed tax. A DPT liability will only arise when the ATO issues a DPT assessment (no later than seven years after the tax return has been lodged).

It is proposed that there will be a complex set of rules dealing with the timing of ATO and taxpayer procedures in relation to the issue of DPT assessments. However, in essence, these rules are designed to allow the Commissioner of Taxation to issue an assessment based on information available and require the taxpayer to respond in compressed timeframes during the review period.

At the completion of the review period, the taxpayer has 30 days to lodge an appeal (through the court process).

However, at any point throughout the review process, the taxpayer will have the option to amend their tax returns to reflect transfer pricing outcomes acceptable to the Commissioner. These adjustments will be taxable at 30 per cent rather than the DPT rate of 40 per cent (penalties may also apply).

Other comments

It is disappointing that the Government has again decided to depart from the OECD/G20 BEPS action plan by introducing a new tax that is inconsistent with the BEPS recommendations. The essence of the proposed DPT is a transfer pricing adjustment where the ATO considers an Australian taxpayer is not reporting adequate profits because of related party transactions. The DPT seeks to permit the Commissioner to reconstruct arrangements in circumstances not permitted by existing transfer pricing and general anti-avoidance rules and goes beyond the recommendations in relation to BEPS Actions 8, 9 and 10.

There are also aspects of the rules that require further clarification. For example, the consultation paper does not fully describe how the DPT can be reconciled with Australia's tax treaty obligations, other than to say that "the DPT due and payable will not be reduced by the amount of tax paid in a foreign jurisdiction … consistent with the application of penalties under Australia's existing transfer pricing rules." It will also be important to understand how existing Advanced Pricing Agreements could be affected by the DPT.

The UK DPT contains a number of specific exemptions from the effective tax mismatch requirement for transactions with charities, pension schemes, sovereign wealth funds and certain widely held funds. The consultation paper does not mention the proposed treatment of such transactions. Furthermore, the UK DPT has an exclusion for loan relationships. However, the Australian consultation document notes that the pricing of debt will be taken into account in determining any DPT liability.

Implementation of anti-hybrids legislation

As speculated in the lead up to this year's Federal Budget, the Government has announced that it will implement the OECD developed anti-hybrid rules (refer to the PwC Tax Policy Bulletin for an overview), with some minor modifications as recommended by the Board of Taxation in its report to the Government.

The Australian anti-hybrid rules will apply to payments made on or after the later of 1 January 2018 or six months after the relevant law is enacted. As a general rule, pre-existing arrangements will not be grandfathered nor will transitional rules be introduced.

This prospective start date is welcome news given the inherent complexity of the anti-hybrid rules and the substantial change in law required because it:

- Gives taxpayers time to assess and restructure existing arrangements
- Provides greater clarity for the application of the rules by ensuring legislation is available prior to the commencement date, and
- Provides sufficient opportunity for Treasury and stakeholders to work through operational and interaction challenges expected to arise upon implementation of the rules into the Australian law (such as thin capitalisation, interest withholding tax, transfer pricing, definitions, ordering of priority regimes, tax consolidation etc).

The Board helpfully acknowledged in its report the interaction between the general anti-avoidance rule (in Part IVA) and changes to the tax system. It is encouraging that taxpayers should expect to have the freedom to restructure existing hybrid arrangements affected by this measure. Whilst a legislative carve-out from Part IVA will not be provided, administrative guidance is expected to be issued by the ATO contemporaneously with the introduction of the legislation. We see this as important because the anti-hybrid rule may require many taxpayers to restructure their arrangements.

The measure contains some minor modifications at the recommendation of the Board, including that:

Recommendation 1 (financial instruments rule) will not apply to financial instruments with a term of three years or less where the hybrid mismatch is merely a timing difference.

Optional recommendation 2.2, which restricts foreign tax credits under a hybrid transfer, will not be implemented immediately, albeit may be implemented if integrity concerns arise in the future.

Optional recommendation 5, which contains specific recommendations for the tax treatment of reverse hybrids (i.e. changes to the controlled foreign company (CFC) rules to ensure attribution of income allocated under a reverse hybrid, limiting tax transparency for non-resident investors, and introducing tax filing and information report requirements), will not be implemented immediately, but may be considered if integrity concerns arise in the future.

Analysis on whether arrangements are affected by the anti-hybrid rule is complex particularly given the need to understand foreign tax rules in extreme detail. However, this complexity is substantially compounded by the introduction of the "imported mismatch rule". This specific integrity rule is designed to prevent taxpayers from indirectly shifting tax advantages arising from a hybrid mismatch from a jurisdiction that has not implemented the rules.

The imported mismatch rule will have broad ramifications as it extends to both financing and non-financing payments (for example, deductions can be disallowed for a broad range of payments including interest, royalties, rents and payments for services). Intra-group supply chains and non-financing transactions that fund a hybrid financing arrangement are likely to be impacted by the imported mismatch rule.

There are a number of inevitable practical difficulties associated with the imported mismatch rule, particularly given:

- The requirement to trace funds flows through (potentially multiple and unlimited) chains of entities in a global group, and the requirement to apportion deduction denials across jurisdictions that have implemented this rule.
- The need for taxpayers to understand the foreign tax treatment of payments that have no direct connection with their particular (Australian) operations, and the need for taxpayers to keep abreast of legislative developments in foreign jurisdictions that may change the position taken in Australia.

  The need for revenue authorities (including the ATO) to have a complete understanding of the respective tax treatment for each entity in a wider chain of entities (even where there are no consequences from an Australian revenue perspective).

The Board cautioned that by Australia adopting the anti-hybrid rules in advance of most other countries, an unfair compliance burden will be placed on Australian taxpayers having to disprove application of the imported mismatch rule. Whilst the Board recommended that the Government consider possible mechanisms to reduce uncertainty and the compliance burden associated with this rule (for example, by introducing a 'significant global entity' threshold as used in the MAAL or some other form of safe harbour), the Government has decided to implement the imported mismatch rule in its entirety.

We anticipate that the Australian Government will be faced with significant difficulties in drafting this legislation and ensuring that it appropriately targets the intended arrangements without inadvertently extending its scope beyond the policy objective.

Finally, given complexities and interactions identified by the Board in its report, the Government has asked the Board to undertake a subsequent review to examine how best to deal with deductible/frankable hybrid mismatch arrangements that arise in relation to regulatory capital (see terms of reference). The Board has been asked to consult with stakeholders and report back to Government by the end of July 2016. This will enable alignment with the commencement date of the broader anti-hybrid rules.

No change to thin capitalisation limits

Despite pre-Budget speculation, no changes to Australia's thin capitalisation rules were announced in this Budget.

Adoption of new OECD transfer pricing guidance

The Government has proposed adopting revised transfer pricing guidance issued by the OECD in 2015. This change means that Australian taxpayers will need to consider the new OECD transfer pricing guidance when they self-assess whether they have complied with the Australian transfer pricing rules. It is proposed that the new guidance will be incorporated into Australian law for years beginning on or after 1 July 2016.

The changes issued by the OECD in 2015 introduce a much stronger focus on substance over legal form. Specific changes in the 2015 guidance include:

- A framework for analysing risk allocations between related parties
- Guidance on when recharacterisation or non-recognition of transactions may be appropriate
- Detailed new guidance on the transfer pricing considerations for intangibles
- Revised guidance on cost contribution arrangements (also known as cost sharing arrangements)
- Guidance on transfer pricing for low value adding intra-group services (e.g. routine management services.

Once the new guidance is incorporated into Australian law, we expect taxpayers will need to ensure their transfer pricing documentation addresses this guidance to satisfy the documentation standard required for transfer pricing penalty protection.

04

Transparency

Mandatory disclosure of aggressive tax arrangements

The Government has issued a Discussion Paper on the Organisation for Economic Co-operation and Development's (OECD) proposals for Mandatory Disclosure Rules. These 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.

The purpose of the Paper is to seek community views on how Mandatory Disclosure Rules should be framed in the Australian context, having regard to the disclosure rules that are currently available to the Australian Taxation Office (ATO). The Paper also provides an outline of the key recommendations of the OECD, and the Government's preliminary views in relation to those recommendations.

Voluntary tax disclosure code

In February 2016, the Board of Taxation provided a Report to Government on a voluntary tax transparency code (TTC) which, in delivering the 2016-17 Budget, the Government has embraced as one of the key elements of a stronger tax compliance regime, encouraging all companies to adopt the TTC from the 2016 financial year onwards. The TTC designed by the Board is a set of principles and 'minimum standards' to guide voluntary disclosure of tax information by businesses. The Board expects that the TTC will evolve over time in response to changes in corporate governance practices, the legal and commercial environment, and developments in global tax transparency initiatives.

The TTC is divided into two Parts, with the Board recommending that both Part A and Part B be adopted by large businesses (being businesses with aggregated 'TTC Australian turnover' of AUD 500 million or more), while medium businesses (being businesses with aggregated TTC Australian turnover of at least AUD 100 million but less than AUD 500 million) adopt Part A only.

Under Part A, businesses would, as a minimum, disclose the following information:

- A reconciliation of accounting profit to tax expense and to income tax paid or income tax payable
- Identification of material temporary and non-temporary differences
- Accounting effective company tax rates for Australian and global operations (pursuant to Australian Accounting Standards Board (AASB) guidance).

Under Part B, businesses would, as a minimum, disclose the following information:

- Approach to tax strategy and governance
- Tax contribution summary for corporate taxes paid
- Information about international related party dealings.

Some large businesses already report this type of information publicly (for example, an Extractive Industries Transparency Initiative report or a European Union Tax Directive report) however, for others this would be a significant increase in public transparency on their tax affairs and an increase in compliance costs. As stated in the Report, the TTC is a voluntary minimum standard of content and it is expected that some businesses will choose to provide additional disclosures.

The Report does not recommend additional oversight or penalties for misleading disclosure of TTC information. However, in reaching this conclusion, the Board had regard to existing sanctions under other laws for providing misleading disclosure such as sanctions under Australia's company law. Under the TTC, businesses would make their TTC report publicly available (for example, by publishing it on the business' website) and provide the ATO with a link to the report for inclusion in a central website that provides a link to all publicly-issued TTC reports. It would be expected that the AASB will develop guidance material to assist businesses in meeting the standard required by the TTC, and to establish a common definition of the term 'effective tax rate' to ensure consistency, including addressing issues such as amended assessments, impairments and foreign currency translation.

Finally, in its report the Board states that "the TTC is more advanced and more comprehensive than existing tax transparency measures from other countries and organisations. However, due to the flexibility in the TTC the Board has received strong support from businesses and associations and expects it to be widely adopted".

Protection for whistleblowers disclosing tax avoidance behaviour

The Government will introduce new arrangements to better protect individuals who disclose information to the ATO on tax avoidance behaviour and other tax issues. This measure is to take effect from 1 July 2018 and under the new arrangements, individuals, including employees, former employees and advisers, disclosing information to the ATO will be better protected under the law.

Substantial increase in penalties for failing to meet disclosure requirements

A significant increase has been proposed in the maximum penalties that can apply for failing to disclose information to the ATO. This will apply to 'significant global entities' (i.e. entities that are part of a group with global turnover of $1 billion or more). The new maximum penalty will be $450,000 (up from the current $4,500) for failing to meet disclosure obligations. For example, this would include entities that fail to meet their reporting requirements under the Country-by-Country reporting legislation that was enacted in 2015.

In addition, penalties relating to making statements to the ATO will be doubled, increasing the penalties imposed on multinational companies that are reckless or careless in their tax affairs.

05

Personal Tax

Individual taxpayers have been spared any direct tax increases, but some high-income earners are likely to be impacted by a range of other measures announced as part of this Budget, including the reforms to *superannuation*. Some middle-income earners have been afforded modest tax relief with a slight change to the threshold from which the second-highest marginal tax bracket applies.

Income tax rates

It is well known that as the average income of Australians increases with wage inflation, without a corresponding change in income tax thresholds, an increasing number of taxpayers find themselves in higher marginal tax brackets – otherwise known as 'bracket creep'. It is becoming inevitable that any comprehensive reform of the tax system will ultimately need to address this issue, since bracket creep if left unchecked has the potential to reduce workplace participation. For broader analysis on this issue please refer to the recent PwC Australia publication *'Bracket creep: Do we treat the symptoms or cure the disease?'*

We see in this Federal Budget a modest attempt to address the current bracket creep via the announced proposal to increase the threshold at which the second-highest marginal tax bracket of 37 per cent begins to apply, from $80,001 to $87,001. According to the Government's modelling, this will prevent approximately 500,000 taxpayers from entering this tax bracket until the 2019-20 income year.

The proposed tax rates for the coming 2016-17 income year are contained within the tables below:

Taxable income threshold range ($)	Resident individual 2016-17 marginal income tax rate (%)	Non-resident individual 2016-17 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

The Government has not proposed any extension to the Temporary Budget Repair levy which will apply until 30 June 2017, after which it will be abolished. The levy applies at a rate of 2 per cent on that part of an individual's taxable income exceeding $180,000.

The Government has also not proposed any changes to the rules for allowing tax deductions for work related expenses.

The following table sets out a comparative of the amount of income tax and Temporary Budget Repair levy payable on a range of taxable income amounts of a resident individual for the current tax year and for the year commencing 1 July 2016, ignoring the Medicare levy and surcharge, the low income tax offset and any other tax offset entitlements.

Medicare

The Medicare levy rate remains at 2 per cent of taxable income.

However, for the 2016-17 year, the Medicare levy low-income thresholds have been increased for singles, families, and single seniors and pensioners. The movements aim to offset growth in the Consumer Price Index (CPI) to ensure that low-income taxpayers are exempt from paying the Medicare levy. The increased thresholds are:

- Individuals $21,335 (increased from $20,896)
- Families $36,001 (increased from $35,261), with an additional $3,306 for each dependent child or student (increased from $3,238)
- Single seniors and pensioners $33,738 (increased from $33,044), senior and pensioner couples $46,966 (increased from $46,000)

Private health insurance and Medicare levy surcharge

The private health insurance rebate percentage is indexed annually at 1 April. Note that the pause on indexation of the Medicare levy surcharge income thresholds is proposed to be extended until 30 June 2021.

Taxable income ($)	2015-16 tax payable ($)	2016-17 tax payable ($)	Temporary Budget Repair levy ($) - remains same for both tax years	2015-16 total payable ($)	2016-17 total payable ($)
37,000	3,572	3,572	0	3,572	3,572
75,000	15,922	15,922	0	15,922	15,922
100,000	24,947	24,632	0	24,947	24,632
150,000	43,447	43,132	0	43,447	43,132
180,000	54,547	54,232	0	54,547	54,232
200,000	63,547	63,232	400	63,947	63,632
300,000	108,547	108,232	2,400	110,947	110,632
400,000	153,547	153,232	4,400	157,947	157,632

Accordingly, the current rebate entitlements and surcharge applicable to those individuals who do not have the appropriate health insurance hospital cover, from 1 April 2016 to 31 March 2017 are as follows:

	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	26.791%	17.861%	8.930%	0%
Aged 65 - 69 years	31.256%	22.326%	13.395%	0%
Aged 70 or over	35.722%	26.791%	17.861%	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.

Other

As expected, the Government did not announce any changes to remove or limit 'negative gearing' for rental property investment.

The Government also made no announcement in regards to the so-called 'backpacker tax' measures which were announced in the 2015-16 Budget. The original proposal, which was scheduled to apply from 1 July 2016 to treat most working holiday makers to Australia as non-residents for tax purposes, regardless of the length of time of their working holiday, has most recently been subject to further consideration.

06

Superannuation

Superannuation has been a strong focus of this year's Federal Budget. A raft of changes have been announced - some which will impact on the ability of Australians to save for their retirement, while other measures will provide incentives and opportunities for lower income earners to bolster their superannuation savings. The following measures were announced as part of the Government's superannuation reform package to improve the sustainability, flexibility and integrity of the super system.

Reduced concessional contribution caps

With effect from 1 July 2017, concessional contribution caps, i.e. for contributions which come from pre-tax income, are to be reduced to $25,000 per annum (currently set at $30,000 for those individuals aged under 50 and $35,000 for those over 50 years of age), limiting the ability of people to grow their retirement savings.

However, Australians will now be given the opportunity to make additional concessional contributions where they have not reached concessional contribution caps in prior years. This measure, which will apply from 1 July 2017, will only be available to those individuals with super balances less than $500,000, and will enable a carry forward of 'unused cap amounts' to allow a catch up on contributions. This measure is intended to allow people with interrupted work patterns (for example women or carers) to accumulate superannuation balances commensurate with those who do not take breaks from the workforce.

Removal of 10 per cent rule for deductible personal contributions

From 1 July 2017, Australians up to age 75 will have the ability to claim a deduction for personal superannuation contributions regardless of their work circumstances. This will negate the need for salary sacrificing arrangements with employers and enable people to claim a deduction to top up their super contributions up to the new concessional contribution cap.

Decreased threshold for Division 293 tax

From 1 July 2017, the Government will be reducing the threshold at which high income earners pay an additional 15 per cent tax (commonly referred to as "Division 293 tax") on their concessional superannuation contributions from $300,000 to $250,000.

Non-concessional (after-tax) contributions

A lifetime cap will be applied to non-concessional contributions. The new $500,000 lifetime cap takes effect immediately and applies to all non-concessional contributions made on or after 1 July 2007. However, amounts made before 7.30pm on 3 May 2016 (Budget night) cannot result in an excess. This new lifetime cap will replace the current non-concessional annual cap of $180,000 (six times the concessional contributions cap) as well as the three-year bring forward provisions that enabled contributions up to $540,000 to be made.

Work test for contributions

From 1 July 2017, the age at which Australians will have to satisfy a work test in order that they are able to make superannuation contributions will be increased from 65 to 74 years of age. This will facilitate people being able to improve their retirement savings for a longer period of time regardless of their working arrangements.

Contributions for low income spouses

The ability to claim a tax offset of up to $540 per annum for spouse contributions has become more accessible with the income threshold for spouses increased from $10,800 to $37,000. This measure is intended to apply from 1 July 2017.

$1.6 million cap on retirement phase

The Government has announced it will restrict the amount of a person's superannuation balance that can be transferred into pension phase, which attracts greater concessional tax treatment, to $1.6 million. While this does not restrict people's ability to save in superannuation, balances above this amount will still be deemed to be in accumulation phase attracting the normal 15 per cent tax rate on earnings. This measure will take effect from 1 July 2017. Those already in 'pension' phase will be expected to reduce their retirement balance to $1.6 million by 1 July 2017, with the option of returning the excess amounts back to accumulation.

Low Income Superannuation Tax Offset (LISTO)

Effectively replacing the Low Income Super Contributions (LISC) scheme, from 1 July 2017, low income earners will receive a tax offset (to their super fund) to compensate for tax paid on their super contributions. Up to a $500 non-refundable tax offset will be paid to superannuation funds for those members for whom concessional contributions have been made, with adjusted taxable incomes of less than $37,000. This avoids the situation where low income earners were paying more tax on their super contributions than if they received this money as direct salary or wages.

Transition to retirement income streams

Although it is not proposed to abolish Transition to Retirement Income Streams (TRISs), the Government has announced that earnings from assets supporting these benefits will no longer be eligible for tax exemptions. It appears these income streams will remain available to those who have reached preservation age (currently 56 years) regardless of any changes to their work circumstances, however the taxation of the earnings within the fund will be the same as if the fund was in accumulation phase (15 per cent). This measure will apply to all TRISs from 1 July 2017.

Income streams taxed as lump sums

The Government has announced that from 1 July 2017, it will remove rules that currently allow an election to be made for certain income stream payments to be taxed as lump sums.

Anti-detriment payments to be abolished

As predicted in the lead up to the Budget, the Government has announced that it will repeal the anti-detriment payment rules for payments after 30 June 2017.

These provisions enabled a refund of a member's lifetime super contributions tax payments to be paid to their dependants as part of a death benefit payment. Considered to be inconsistently applied and difficult to administer, this will potentially diminish the amount of a death benefit payment to dependants.

07

Private Business

Small businesses with aggregated annual turnover of less than $10 million appear to be the winners under this year's Federal Budget Ten Year Enterprise Tax Plan which is intended to encourage Australians to work, save and invest.

Corporate tax rate reduction for small business entities

In a highly anticipated move, the Federal Government announced that it will reduce the company tax rate from 30 per cent to 27.5 per cent for all incorporated businesses with an annual aggregated turnover of less than $10 million with effect from 1 July 2016.

The corporate tax rate is currently 28.5 per cent for small business entities (broadly, those with annual aggregated turnover of less than $2 million) and 30 per cent for all other companies.

The threshold will then be progressively increased to ultimately have all companies at 27.5 per cent in the 2023-24 income year. The annual aggregated turnover thresholds for companies facing a tax rate of 27.5 per cent is set out in the table below:

Income year	Annual aggregated turnover threshold
2016-17	$10 million
2017-18	$25 million
2018-19	$50 million
2019-20	$100 million
2020-21	$250 million
2021-22	$500 million
2022-23	$1 billion
2023-24	No threshold

In the 2024-25 income year the company tax rate will be reduced to 27 per cent and then be reduced progressively by 1 percentage point per year until it reaches 25 per cent in the 2026-27 income year.

Franking credits will be able to be distributed in line with the rate of tax paid by the company making the distribution. It is unclear how the phasing of the corporate tax reduction will apply to investment companies, i.e. non-business entities.

The lowering of the small business corporate tax rate to 27.5 per cent, coupled with an increase of the qualifying threshold to $10 million from 1 July 2016 is expected to bring early significant cash flow benefits to those small businesses operated through corporate entities.

However, the increased differential between the corporate tax rate and the top marginal tax rate will also have the effect of increasing the amount of ‘top up tax’ payable when private company profits are ultimately distributed to shareholders. Small businesses will therefore need to consider the tax profile of their shareholders and their capacity to frank dividends when considering their annual dividend strategies.

Increased concessions with an increased small business entity threshold

The Government has announced that the small business entity turnover threshold will be increased from $2 million to $10 million from 1 July 2016.

Importantly, all business entities (incorporated or otherwise) that meet the new $10 million aggregated turnover test will be able to access the simplified depreciation rules, including the existing instant asset write-off scheme. This will allow them to claim an immediate deduction for depreciable asset purchases costing less than $20,000 until 30 June 2017.

Increasing access to this scheme will provide significant incentives for many qualifying small businesses to increase their current capital expenditure spend. However, the after-tax consequences of the proposed immediate deduction for depreciating assets should be considered. If this results in a tax loss, there is no immediate cash-flow advantage.

Other concessions to which the increased $10 million threshold will apply from 1 July 2016 include:

- Simplified trading stock rules, giving them the option to avoid end of year stocktake if the value of stock has changed by less than $5,000
- A simplified method of paying PAYG instalments calculated by the Australian Taxation Office (ATO) which removes the risk of under or over-estimating PAYG instalments and the resulting penalties that may be applied
- The option to account for Goods and Services Tax (GST) on a cash basis and pay GST instalments as calculated by the ATO
- Other tax concessions currently available to small businesses, such as fringe benefits tax (FBT) exemptions (from 1 April 2017 to align with the FBT year)
- A trial of simpler business activity statements (BAS) reducing GST compliance costs, with a full roll-out from 1 July 2017.

The current $2 million turnover threshold will be retained to access the small business capital gains tax (CGT) concessions, and access to the unincorporated small business tax discount will be limited to entities with turnover less than $5 million.

The introduction of an increased small business threshold is a welcome move as not all small businesses were able to take advantage of the existing concessions due to the low threshold. However, it is disappointing that the Government has not taken the opportunity to apply this $10 million eligibility threshold to all concessions targeted at small businesses.

Small business thresholds will continue to be inconsistent despite this change. This often leads to confusion and increased compliance costs due to the complexity of the rules applicable to the small business sector. For example, the small business CGT concessions require taxpayers to satisfy either the $6 million net asset value test or the $2 million aggregated turnover test. In contrast a $20 million aggregated turnover test applies for the R&D refundable tax offset rules and debt/equity rules.

Private business could benefit from having a consistent set of thresholds applying, and would have greater access to these small business concessions if the thresholds were increased and indexed annually.

Expanding the unincorporated small business tax discount

The Government will increase the tax discount for unincorporated small businesses incrementally over 10 years from five per cent to 16 per cent. The tax discount will increase to eight per cent on 1 July 2016, remain constant at eight per cent for eight years, then increase to 10 per cent in 2024-25, 13 per cent in 2025-26 and reach a new permanent discount of 16 per cent in 2026-27.

The tax discount applies to the income tax payable on the business income received from an unincorporated small business entity. Access to the discount will be extended to individual taxpayers with business income from an unincorporated business that has an aggregated annual turnover of less than $5 million. The current cap of $1,000 per individual for each income year will be retained.

Private company deemed dividends

The Government has announced that from 1 July 2018 it will make much needed amendments to improve the operation and administration of the private company deemed dividends rules (Division 7A of the Income tax Assessment Act 1936) based on the Board of Taxation's 2015 Post-implementation Review into Division 7A.

These changes are intended to provide clearer rules for taxpayers and assist in easing their compliance burden while maintaining the overall integrity and policy intent of Division 7A. The changes include:

- A self-correction mechanism for inadvertent breaches of Division 7A
- Appropriate safe-harbour rules to provide certainty
- Simplified loan arrangements and a number of technical adjustments to improve the operation of Division 7A and provide increased certainty for taxpayers.

We eagerly await the release of further details in relation to these measures.

08

Taxation of Financial Arrangements

The Government has announced major reforms to the taxation of financial arrangements (TOFA) rules reduce their scope, decrease compliance costs and increase certainty through the redesign to the TOFA framework. The new simplified rules will apply to income years commencing on or after 1 January 2018, and represent the culmination of two years of work by the Board of Taxation and Treasury to overhaul the TOFA framework.

The existing TOFA provisions were introduced in two tranches in 2003 (in relation to foreign exchange gains and losses) and in 2009 in respect of a broader range of financial arrangements. Since their introduction, these rules have been broadly criticised for increasing complexity and uncertainty for both small and large taxpayers. In this Budget announcement, the Government has acknowledged that the 2009 amendments failed to deliver the anticipated compliance and simplification benefits, and has framed these changes up as 'regulation reform'.

The proposed new rules will contain four key components:

- A 'closer link to accounting' which will strengthen and simplify the existing link between tax and accounting in the TOFA rules
- Simplified accruals and realisation rules, which will significantly reduce the number of taxpayers in the TOFA rules, will reduce the arrangements where spreading of gains and losses is required under TOFA and simplify the required calculations
- A new tax hedging regime which is easier to access, encompasses more types of risk management arrangements (including risk management of a portfolio of assets), and removes the direct link to financial accounting
- Simplified rules for the taxation of gains and losses on foreign currency to preserve the current tax outcomes but streamline the legislation.

The simplified accruals and realisation rules will be welcomed by most taxpayers, which should see a simpler basis of taxation for many interest bearing securities and remove the need for complex accruals calculations in many cases, whilst the closer link to accounting will assist more sophisticated taxpayers with complex financial arrangements. It is also pleasing to see an acknowledgement of the limitations of the current hedging regime with plans to introduce a more flexible regime that should be accessible to a wider range of taxpayers. It is hoped that this will include fund managers and superannuation funds that have had difficulties accessing the current regime.

According to the Budget announcement, it will result in lower compliance costs, and provide simpler rules and more certainty whilst maintaining the objectives of reducing costs and minimising distortions in decision making.

As part of this reform, Government has also indicated that it will incorporate the policy reflected in a number of measures which have previously been announced, but are not yet legislated. These are:

- Taxation of financial arrangements — amendments to tax hedging rules; first announced in the 2011-12 Budget
- Functional currency rules — extending the range of entities that can use a functional currency; first announced in the 2011-12 Budget
- Taxation of financial arrangements — foreign currency regulations — technical and compliance cost savings amendments; first announced in the Mid-Year Economic and Fiscal Outlook 2004-05.

Whilst the start date is nearly two years away, it remains to be seen if the Government can meet this ambitious time frame, considering that the previous iterations of TOFA were nearly 20 years in the making. As with any changes to the tax law of this extent, the devil will be in the detail. We will need to 'watch this space' closely as it unfolds over the next two years.

Removing barriers to the use of asset backed financing

The Government has also announced that it will remove 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. These amendments will ensure that these arrangements are treated in the same way as financing arrangements based on interest bearing loans or investments, and improve access to more diverse sources of capital in Australia. This measure will apply from 1 July 2018.

Asset and Wealth Management

Government to introduce new Collective Investment Vehicles

To complement the commencement of the Asia Region Funds Passport (the Passport), the Government has committed to the introduction of two new types of collective investment vehicles (CIVs) - a corporate CIV and limited partnership CIV, both of which will have flow through status for tax purposes. The corporate CIV will be introduced for income years starting on or after 1 July 2017, with the limited partnership CIV to follow one year later. The new CIVs will be required to meet similar eligibility criteria as managed investment trusts, such as being widely held and engaging primarily in passive investment.

Managed investment trusts are currently the most common form of CIV in Australia, however many foreign investors are unfamiliar with trusts and this acts as a blocker for inbound investment into Australia. The introduction of these new vehicles is a welcome move which should increase the global competitiveness of Australia's funds management industry, and it is pleasing that the Government has committed to implementing these measures swiftly to align with the commencement of the Passport in 2017.

The Passport is an international initiative that facilitates the cross-border offering of eligible collective investment schemes while ensuring investor protection in participating jurisdictions. According to the Statement of Intent signed by Australia in September 2013, the Passport aims to "facilitate the growth and competitiveness of financial markets in the region and the fund management industry, creating a common framework that has the effect of reducing the regulatory inconsistency and overlap faced by collective investment scheme operators seeking to offer CIS [Collective Investment Schemes] in multiple economies". The Asian Region is a growth area for funds management, with USD 4.5 trillion assets under management as at June 2015. A broader range of CIVs combined with the Passport and the new Attribution Managed Investment Trust (AMIT) regime (expected to be enacted by Parliament this week) will help Australian funds get a foothold throughout the broader Asian region.

Last week the Assistant Treasurer and Minister for Small Business signed the Passport Memorandum of Co-operation which sets out the internationally agreed rules and cooperation mechanisms of the Passport, and comes into effect on 30 June 2016. From this time, participating economies have up to 18 months to implement their domestic arrangements to support the Passport. It is expected that the first Passport-compliant schemes will be offered in 2017. For further information on the Passport, please refer to our publication *Asian Passports, the coming of age.*

10

Indirect Tax

Goods and services tax

Extending GST to low value goods imported by consumers

Subject to the unanimous agreement of the States, the Government has announced that the goods and services tax (GST) will apply to low value goods imported by consumers from 1 July 2017.

Similar to the measures announced in last year's Budget in relation to the supply of digital services and intangibles by non-residents to Australian consumers, overseas suppliers that have an Australian turnover greater than $75,000 will be required to register for, collect and remit GST on the sale of low value goods to Australian consumers.

These arrangements will be reviewed in two years to ensure they are operating as intended and to take account of any international developments.

It is estimated this measure will increase GST payments to the States and Territories by $270 million over the forward estimates. This measure should also ensure that Australian and foreign suppliers of goods are treated equally under the GST law. Furthermore, imposing GST on the foreign supplier (rather than on the entry of the goods into Australia) should ensure that goods are not unduly delayed during customs clearance procedures.

Small business GST concessions extended

As noted earlier, the Government announced in the Budget that it will increase the small business turnover threshold from $2 million to $10 million. This will provide small businesses with a turnover less than $10 million the option to elect to account for GST on a cash basis (rather than accruals) or to pay GST by instalments (as prescribed in the GST law).

This measure is designed to ease the tax burden on small businesses.

Increased integrity measures for the Wine Equalization Tax

To address a range of integrity concerns with the Wine Equalization Tax (WET) identified by the Treasury in a 2015 discussion paper, the WET rebate cap has been reduced and eligibility criteria tightened.

The cap will gradually reduce from $500,000 currently to $350,000 on 1 July 2017, followed by a further reduction to $290,000 by 1 July 2018. In addition, tighter eligibility criteria will apply from 1 July 2019. While we do not have the detail on specific eligibility criteria which may be introduced, based on the 2015 discussion paper, measures may include:

- Tightening the definition of 'producer of wine'
- Restricting eligibility to exclude bulk, unpackaged and unbranded wine
- Requirements to demonstrate payment of WET to access a rebate

What can be concluded though is that these measures will close perceived loopholes relating to the administration of the WET rebate and reduce the impact of the scheme on the budget bottom line.

Customs

Australian Trusted Trader

The Australian Government's trade facilitation pilot programme, Australian Trusted Trader (ATT), has been fully funded to the tune of $69.9 million over four years. This funding includes $6.3 million in capital expenditure to facilitate implementation of the required people, process and systems changes to support ATT's ongoing operation. During a pre-budget announcement, the Minister for Immigration and Border Protection affirmed the Government's commitment to ATT and the role the programme plays in the achievement of Australia's G20 growth strategy.

The announcement, and the size of initial funding allocated by the Government, has provided the assurance that the ABF will have access to sufficient resources to deliver real benefits to participants. It also helps to quell doubts of the Australian Border Force's capability to work with industry and explore bespoke benefits that may be achievable for Trusted Traders under the umbrella of the ATT.

Named benefits to be implemented in forward years include periodic and streamlined reporting, duty deferral and streamlined clearance in Australia and abroad. These benefits will reduce international supply chain compliance costs and provide greater certainty.

Excise hike for tobacco products

Perhaps the worst kept secret of the 2016-17 Budget, the expected hike in tobacco excise has received bipartisan support in recent weeks. Forecast to raise $4.7 billion over the forward estimates, Government plans to raise tobacco excise and equivalent customs duty by 12.5 per cent per year from 1 September 2017 until 2020.

These measures will build on previous increases of 12.5 per cent over the last four years and will come into effect in September of each forward year. In total, the changes will bring tobacco excise in Australia to almost 69 per cent of the price per stick (based on current prices).

In addition to these changes, Government will make changes to the Customs Act 1901 and Excise Act 1901 to introduce tough new sanctions, including increasing the range of enforcement options available for illicit tobacco offences. To enforce these sanctions, additional funding to strengthen efforts to combat illicit trade in tobacco has also been allocated, with $7.7 million provided over the next two years to support the Department of Immigration and Border Protection's 'Tobacco Strike Team.'

Other key indirect tax measures

In addition to these measures:

- Government has committed to the signing and implementation of the Trans-Pacific Partnership (TPP) Free Trade Agreement - with an associated revenue reduction of $195 million from associated tariffs. This relative small reduction highlights that much has already been achieved through existing Free Trade Agreements with TPP countries.
- In accordance with the World Trade Organisation Information Technology Agreement, Government will reduce tariffs on information technology products from 1 January 2017. This reduction will be reciprocal and reduce costs associated with IT products for consumers and businesses.
- A limited excise refund scheme for distillers and producers of low strength fermented beverages will be introduced from 1 July 2017, with an estimated cost to revenue of $9.0 million over the forward years.

11

Other tax measures

Establishing the Tax Avoidance Taskforce

The Government will provide $678.9 million to the Australian Taxation Office (ATO) over the forward estimates period of four years to establish a new Tax Avoidance Taskforce which will consist of around 1,300 jobs in the ATO, including 390 new specialised officers. This will enable the ATO to undertake enhanced compliance activities targeting multinationals, large public and private groups and high wealth individuals.

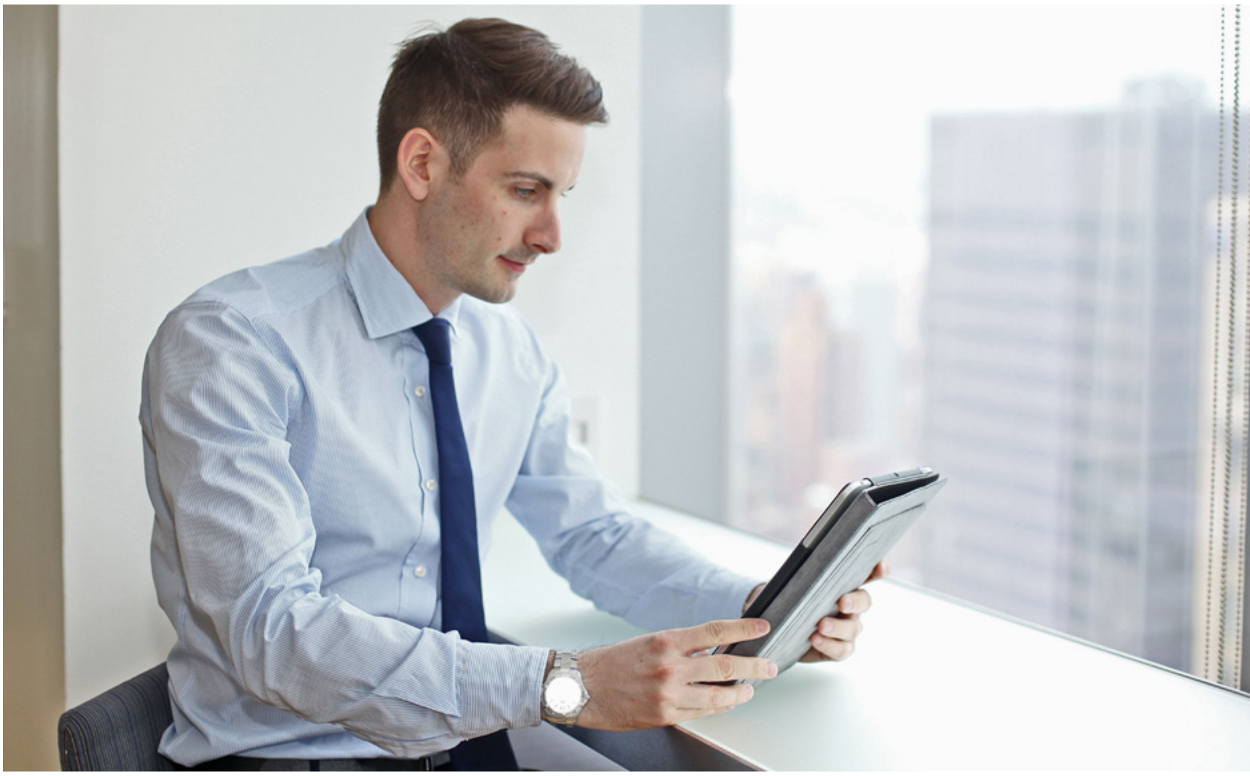
According to the Treasurer, this measure provides the ATO with a 55 per cent increase in funding for compliance programs targeting multinationals and high wealth individuals, with a 43 per cent increase in resources devoted to tackling multinationals. The Government will also ensure the ATO has access to the information it needs by enhancing information sharing between the ATO and the Australian Securities and Investments Commission (ASIC). The Tax Avoidance Taskforce will be led directly by the Commissioner of Taxation who will provide regular progress reports to Government to provide transparency to the community, with the first report to be provided before the end of the year.

In his media statement, the Treasurer states that external experts will be appointed to play a critical role in supporting the Taskforce, including the formation of a panel of eminent former Judges which will review any proposed settlement arrangements to ensure they are fair and appropriate. Additionally the Treasurer has stated that the Taskforce will work closely with its partner agencies including the Australian Crime Commission, the Australian Federal Police and AUSTRAC, and that new legislation will be introduced allowing the ATO to improve information sharing and analysis with ASIC which will lead to a more efficient approach to dealing with tax crime.

This increased funding comes at a time when the ATO is keenly focused on international tax risks, as evidenced by the release just last week of four taxpayer alerts dealing with thin capitalisation, implementation of the Multinational Anti Avoidance Law that was legislated last year, arrangements involving related party cross currency swaps, and cross-border leasing arrangements.

12

Forward Tax Agenda



The Prime Minister is expected to ask the Governor-General to dissolve both Houses of Parliament within the next week or so, with a double dissolution election likely to be held on 2 July 2016. Whilst the practicality of implementing any measure originating from a budget handed down in an election year is complicated, this year it is even more so due to the fact that the election will be held so soon after the Budget. In particular, many of the key tax measures announced in this year's Federal Budget will not be legislated before Parliament is dissolved meaning this year's Budget is for all intents, the current Government's election policy platform.

Given that the forward tax agenda will largely hinge on the outcome of the next election, below is a comparison of the tax and superannuation policies of the two major political parties that have been announced to date. Of course, with a long election campaign ahead, there is surely more to come from both major political parties on tax reform, commencing with the Opposition's Budget Reply on Thursday 5 May 2016.

Policy area	Coalition Government policy	Labor Party policy
Company income tax rate	• Progressive reduction of the corporate tax rate to 25 per cent over 10 years for all companies. • Small business companies (those with annual aggregated turnover of less than $10 million) will benefit from lower rates sooner.	• No formally announced policy. Whilst the Labor Party has previously stated that it supports a lower corporate income tax rate, it has more recently indicated that it does not support corporate income tax rate cuts for large businesses at this time.
Personal income tax rates	• Increase in the threshold at which the 37 per cent marginal tax rate cuts in from $80,001 to $87,001 to address bracket creep. • Increase in the unincorporated small business tax discount phased in over 10 years.	• No announced policy, however the Labor Party has criticised the Government's intention to allow the Temporary Budget Repair levy to lapse.
Goods and services tax (GST)	• No change to GST rate or base. • GST to be extended to low value imported goods.	• No announced policy, however the Labor Party has indicated it will make no changes to the GST rate or base.
Multinational tax avoidance / transparency / transfer pricing	• Introduction of a Diverted Profits Tax, a 40 per cent tax on profits that are artificially diverted from Australia. • Amendments to the transfer pricing rules to give effect to OECD BEPS recommendations. • Implementation of the OECD BEPS recommendations to eliminate hybrid mismatch arrangements with minor amendments as recommended by the Board of Taxation. • Increased penalties for 'significant global entities' that fail to disclose information to the ATO (100 times current penalty amounts). • More funding to the ATO to establish of new a Tax Avoidance Taskforce (also targeting tax avoidance by high wealth individuals).	• Amend the thin capitalisation rules to limit the amount of debt deductions multinational companies can claim in Australia to the debt-to-equity ratio of a company's entire global operations. • Better align Australia's tax treatment of hybrid entities and instruments with those of foreign countries to reduce the opportunity for companies to claim tax exemptions and deductions in more than one country. • Provide additional funding to the ATO to properly investigate and pursue multinational profit shifting. • Increase penalties for 'significant global entities' that fail to lodge a Country-By-Country report (50 times current penalty amount) • Restore the $100 million threshold for public reporting of tax information of large private companies by the ATO. • Establish a publicly accessible central register of beneficial ownership of Australian companies, trusts and other corporate structures.

Policy area	Coalition Government policy	Labor Party policy
Superannuation	• Reduce the threshold for the additional 15 per cent contribution tax for high income earners from $300,000 to $250,000. • $1.6 million cap on balances in pension phase. • Reduce concessional contributions caps to $25,000. • Removal of 10 per cent rule for deductible personal contributions. • Introduce a $500,000 lifetime non-concessional contributions cap. • Changes to the work-test age requirements. • Increased income threshold for low income spouse contributions. • Introduce a Low Income Superannuation Tax Offset. • Changes to transition to retirement income streams. • Remove ability for certain income stream payments to be taxed as lump sums. • Anti-detriment payments to be abolished.	• Reduce the threshold for the additional 15 per cent contribution tax for high income earners from $300,000 to $250,000. • Introduce a 15 per cent tax on superannuation fund income exceeding $75,000 in the pension phase.
Tobacco excise	• Four annual 12.5 per cent increases in excise commencing on 1 September 2017.	• Four annual 12.5 per cent increases in excise commencing on 1 September 2017.
Capital gains tax (CGT)	• No changes to CGT.	• Reduce the CGT discount for individuals to 25 per cent for all assets purchased on or after 1 July 2017. Investments made before this date will not be affected by this change.
Negative gearing	• No changes to negative gearing.	• From 1 July 2017, negative gearing will be limited to new housing. Investments made before this date will not be affected by this change.

Policy area	Coalition Government policy	Labor Party policy
Innovation	• The National Innovation & Science Agenda contains the following tax-related measures: – new tax incentives for investors who support innovative start-ups including a 20 per cent non-refundable tax offset based on the amount of the investment (capped at $200,000) and a CGT exemption for investments held for between one and ten years* – increasing access to company losses by replacing the same business test with a more flexible "predominantly similar business test" – changes to Venture Capital Limited Partnerships, including a new 10 per cent non-refundable tax offset for partners in Early Stage Venture Capital Limited Partnerships* – providing a new option to self-assess the effective life of acquired intangible assets for depreciation purposes.	• Introduce an 'Australian Angel Investment Scheme' will provide: – an upfront 50 per cent tax deduction for an investment up to a maximum of $200,000 per year – investors can 'carry back' tax relief if they do not reach the maximum $200,000 cap in any particular year – full CGT exemption for equity held in the startup venture for more than three years – allow realised losses following investment in the scheme to be deducted against wage and salary income, and – defer CGT on investments if the investor directs a prior capital gain into a new startup venture.

**Note: This measure is already before Parliament.*

In addition to the measures announced in the Budget and noted above, there are a number of other tax measures that the Government has been pursuing which have not yet been enacted. These include:

- Introduction of a statutory remedial power for the Commissioner of Taxation. This was previously included in a Bill that lapsed on proroguing of Parliament on 15 April 2016
- Implementation of the new double tax agreement between Australia and Germany that was signed on 12 November 2015
- Reform the GST law to address the 'double GST treatment' of digital currencies such as Bitcoin (a Treasury discussion paper was released on Budget night to commence consultation on this measure).

Whilst this year's Federal Budget has contained a range of substantial reforms focusing on growth and fairness, it is disappointing that the Government has not delivered comprehensive tax reform. It is hoped that once the "fairness" debate has subsided, both sides of the political divide can refocus their efforts on real tax reform, which will include a close look at the way in which consumption and investment are taxed in Australia and the interaction of State and Federal taxes.

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