CAPITOL GROUP ADVISERS
Accountants and Financial Planners

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Federal Budget 2015 wrap-up

Small business is a sector that came out a clear winner from the 2015-16 federal budget delivered by the Treasurer Joe Hockey. Despite the lead-up mutterings that the budget was going to be "dull and boring", there were nevertheless a few surprises contained in the pages of the budget papers.

Many key budget announcements that comprised the government's small business package were leaked pre-budget and confirmed in the final budget papers. Details of the following are spelled out below, but they include:

- a reduction in the small company tax rate to 28.5%
- a temporary immediate write-off for capital assets acquired by small businesses
- an immediate deduction for professional expenses associated with starting a new business; and
- CGT roll-over relief for changes to an entity structure.

The measures that were previously unknown include:

- while the 1.5% tax cut for small companies has been long expected, the government unexpectedly announced that the current maximum 30% franking credit would still be available to those companies' shareholders. This should allay the fears of the small business community that the tax cut would merely have resulted in "mum and dad" shareholders of family companies paying the extra 1.5% in top-up tax.
- The 5% discount on the tax liability of unincorporated

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small business entities was largely unanticipated. This caters for the vast majority of small businesses that are not companies. The budget papers were silent as to whether an individual who receives income from a trading trust is entitled to this discount. The devil will be in the detail once draft legislation is released.

- The $20,000 threshold for the immediate write-off of capital assets is much higher than the $10,000 cap that has been widely speculated in recent weeks. The benefit however has a time limit, and only applies until June 30, 2017.

The budget contained a proposal for a so-called "Netflix tax" (that is, extending the GST to digital products and services imported by consumers in Australia). However, another rumoured GST change, to decrease the GST exemption threshold of $1,000 that applies to purchases of imported goods, did not make an appearance.

The Treasurer's touted "Google tax" was also a notable absentee. In its place, the government plans to implement an anti-avoidance rule specifically directed towards very large multinationals. Other anti-avoidance announcements aimed at the same taxpayers illustrate intentions to "combat multinational tax avoidance".

As promised, there were no new changes for superannuation and some adjustments for pension entitlement tests. There were few other notable budget impacts for personal taxation. The budget announcement which will have the most significant impact on middle Australia is the child care reform package.

Individuals

Personal tax rates

Personal tax rates will not change, and the 2% Temporary Budget Deficit Levy for taxable incomes over $180,000 will not be extended. The budget confirmed that the levy will, as expected, cease at the end of the 2016-17 income year.

Work related car expenses

The government announced its intention to change the methods of calculating work related car expense deductions from the 2015 16 income year. The "12% of original value method" and the "one third of actual expenses method", which are used by less than 2% of those who claim work related car expenses, will be removed.

The "cents per kilometre method" will be modernised by replacing the three current rates based on engine size with one rate set at 66 cents per kilometre to apply for all motor vehicles, with the Commissioner of Taxation responsible for updating the rate in following years. The "logbook method" of calculating expenses will be retained. These changes will not affect leasing and salary sacrifice arrangements.

Medicare levy thresholds

The government will increase the Medicare levy low-income thresholds for singles, families and single seniors and pensioners from the 2014 15 income year, to take account of movements in the consumer price index (CPI) so that low income taxpayers generally continue to be exempted from paying the Medicare levy.

Specifically:

- for singles, the threshold will be increased to $20,896
- for couples with no children, the threshold will be increased to $35,261 and the additional amount of threshold for each dependent child or student will be increased to $3,238
- for single seniors and pensioners, the threshold will be increased to $33,044.

Higher Education Loan Program (HELP) – recovery from overseas debtors

The government will extend the HELP repayment framework to debtors residing overseas. From 2016-17, HELP debtors residing overseas for six months or more will be required to make repayments of their HELP debt if their worldwide income exceeds the minimum repayment threshold at the same repayment rates as debtors in Australia.

Zone Tax Offset to exclude 'fly-in fly-out' and 'drive-in drive-out' workers

The government will exclude "fly-in fly-out" and "drive-in drive-out" workers from the Zone Tax Offset (ZTO) where their normal residence is not within a "zone". This measure will take effect from 1 July 2015.

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The ZTO is a concessional tax offset available to individuals in recognition of the isolation, uncongenial climate and high cost of living associated with living in identified locations. Eligibility is based on defined geographic zones.

Currently, to be eligible for the ZTO, a taxpayer must reside or work in a specified remote area for more than 183 days in an income year. According to the government, it is estimated that around 20% of all claimants do not actually live full-time in the zones. Many of these are FIFO workers who do not face the same challenges of remote living that the ZTO was designed to address.

Those fly-in fly-out workers whose normal residence is in one zone, but who work in a different zone, will retain the ZTO entitlement associated with their normal place of residence.

Families

Child care measures

The government announced a child care package, which includes the following measures.

i. New Child Care Subsidy

A new single Child Care Subsidy (CCS) will be introduced from July 1, 2017 for changes to the existing child care payments. The CCS will replace the current child care fee assistance provided by the Child Care Benefit, Child Care Rebate and the Jobs, Education and Training schemes. Child Care Fee Assistance payments which will cease on June 30, 2017.

Specifically, under the CCS:

- families meeting an “activity test” with annual incomes up to $60,000 (based on 2013-14 income) will be eligible for a subsidy of 85% of the actual fee paid, up to an hourly fee cap
- the subsidy will taper to 50% for eligible families up to annual income of $165,000
- the CCS will have no annual cap for families with annual incomes below $180,000. For families with annual incomes of $180,000 and above, the CCS will be capped at $10,000 per child per year
- the income threshold for the maximum subsidy will be indexed to the CPI with other income thresholds aligned accordingly
- eligibility will be linked to a new activity test to better align receipt of the subsidy with hours of work, study or other recognised activities
- the hourly fee cap in 2017-18 will be set at $11.55 for long day care, $10.70 for family day care, and $10.10 for outside school hours care. The hourly fee caps will be indexed to CPI.

Note: In 2017-18, the family income thresholds will be $65,710 (maximum subsidy), $170,710 (minimum subsidy) and $185,710 (application of the annual cap of $10,000). The annual cap will be indexed to CPI from July 1, 2018.

ii. Interim Home Based Carer Subsidy Program

A new Interim Home Based Carer Subsidy Program will subsidise care provided by a nanny in a child’s home from January 1, 2016.

The pilot program will extend fee assistance to the parents of approximately 10,000 children. Families selected to participate will be those who are having difficulty accessing child care with sufficient flexibility (such as nurses, shift workers, police, etc). Support for families will be based on the CCS parameters, but with a fee cap of $7.00 per hour per child.

iii. Child Care Safety Net

The government will provide additional funding from 2015-16 to provide targeted support to disadvantaged or vulnerable families to address barriers to accessing child care. The assistance will be provided through the Child Care Safety Net, which consists of three programs:

Additional Child Care Subsidy (ACCS). The ACCS will provide additional assistance to supplement the Child Care Subsidy for eligible disadvantaged or vulnerable families.

Inclusion Support Program (ISP). The new ISP will assist families with children with additional needs to access child care. The ISP will provide more funding for services to get the necessary skilled staff and equipment to support children with special needs.

Community Child Care Fund (CCCF). The CCCF will provide grants to child care services to improve access to child care in disadvantaged communities, increase the supply of child care places in areas of high demand

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and low availability, and improve affordability for low income families in areas where the average fees are greater than the CCS fee cap.

iv. No Jab No Pay

The government will ensure that children fully meet immunisation requirements before their families can access certain government payments. From January 1, 2016, families will no longer be eligible for subsidised child care or the Family Tax Benefit (FTB) part A end-of-year supplement unless their child is up-to-date with all childhood immunisations. Exemptions will only apply for medical reasons.

Youth Allowance

The government will amend parental income testing arrangements to provide more support for families with dependent young people who qualify for certain income support payments, including Youth Allowance, ABSTUDY Living Allowance, and the Assistance for Isolated Children Scheme.

From January 1, 2016

- Families with dependent children receiving income support payments would be subject to the Parental Income Test arrangements currently in place for FTB Part A and will no longer be subject to the Family Assets Test or Family Actual Means Test.
- Where a family has a dependent child who receives an individual income support payment and younger siblings who qualify the family to receive FTB Part A, a single Parental Income Test will be applied taking into account all income support benefits the family receive.

From January 1, 2017

- A Maintenance Income Test will be introduced for dependent children receiving individual income support payments. This test will apply to that child only and not include other child support amounts provided in relation to others in the family. This will be of particular benefit to rural and regional families whose children continue to study beyond Year 12.

Family Tax Benefit Part A

The government will reduce the amount of time FTB Part A will be paid to recipients who are outside Australia. From January 1, 2016, families will only be able to receive FTB Part A for six weeks in a 12 month period while they are overseas. Currently, FTB Part A recipients who are overseas are able to receive their usual rate of payment for six weeks and then the base rate for a further 50 weeks.

Portability extension and exception provisions which allow longer portability under special circumstances will continue to apply.

Small business

The government announced a "Growing Jobs and Small Business" package to assist small businesses. Broadly, small businesses with an aggregated annual turnover of less than $2 million will be eligible for the following concessions.

Tax cuts for small business companies and unincorporated entities

The government will deliver a tax cut to all small businesses through:

- a 1.5% tax cut for small companies, and
- a 5% discount on tax payable on income from unincorporated small business activity.

According to the government, this measure will deliver lower taxes to both incorporated and unincorporated small businesses, improving their cash flow and assisting them to grow, compete and hire new workers. These tax cuts will be available from the 2015 16 income year.

(i) 28.5% tax rate for 'small' companies

The government will reduce the company tax rate from 30% to 28.5% for small companies with an aggregated annual turnover of less than $2 million. Companies with an aggregated annual turnover of $2 million or above will continue to be subject to the current 30% rate on all their taxable income.

Importantly, the current maximum franking credit rate for a distribution will remain unchanged at 30% for all companies, maintaining the existing arrangements for investors, such as self funded retirees.

(ii) 5% discount on tax payable by unincorporated 'small' businesses

Individual taxpayers with business income from an

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unincorporated business that has an aggregated annual turnover of less than $2 million will be eligible for a small business tax discount.

The discount will be 5% of the income tax payable on the business income received from an unincorporated small business entity. The discount will be capped at $1,000 per individual for each income year, and delivered as a tax offset.

Temporary accelerated depreciation for small business assets costing less than $20,000

The government will significantly expand accelerated depreciation for small businesses by allowing small businesses with aggregate annual turnover of less than $2 million to immediately deduct assets they start to use or install ready for use, provided the asset costs less than $20,000.

This measure will apply for assets acquired and installed ready for use between 7.30pm (AEST) May 12, 2015 and June 30, 2017. Note that if a single asset costs more than $20,000, the entire value must be allocated to a depreciation pool (see below).

The government also announced that it will suspend the current “lock out” laws for the simplified depreciation rules until June 30, 2017. The lock out rules prevent small businesses from re entering the simplified depreciation regime for five years if they opt out.

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed in the small business simplified depreciation pool (the pool) and depreciated at 15% in the first income year and 30% each income year thereafter.

The pool can also be immediately deducted if the balance is less than $20,000 over this period (including existing pools).

From July 1, 2017, the thresholds for the immediate depreciation of assets and the value of the pool will revert back to existing arrangements.

Immediate deduction for professional expenses

The government will allow businesses to immediately deduct a range of professional expenses associated with starting a new business, such as professional, legal and accounting advice. Currently, some professional costs associated with a new business start-up are deducted over a five year period. This measure will apply from the 2015 16 income year.

CGT roll over relief for changes to entity structure

The government will allow small businesses with an aggregated annual turnover of less than $2 million to change legal structure without attracting a CGT liability at that point. This measure will apply from the 2016 17 income year.

CGT roll over relief is currently available for individuals who incorporate, but all other entity type changes have the potential to trigger a CGT liability. This measure recognises that new small businesses might choose an initial legal structure that they later find does not suit them when the business is more established.

FBT changes for work related electronic devices

The government will allow a FBT exemption from April 1, 2016 for small businesses with an aggregated annual turnover of less than $2 million that provide employees with more than one qualifying work related portable electronic device, even where the items have substantially similar functions.

Currently, an FBT exemption can apply to more than one portable electronic device used primarily for work purposes, but only where the devices perform substantially different functions.

General business

Employee share schemes

In early 2015, the government released draft legislation to implement changes to the taxation of shares and rights acquired under an employee share scheme (ESS). Consultations on the draft legislation identified some minor technical changes that could be made to the legislation.

As part of the federal budget, the government announced a measure to address these issues by:

- excluding eligible venture capital investments from the aggregated turnover test and grouping rules (for the start-up concession)
- providing the CGT discount to ESS interests that are subject to the start-up concession, where options are converted into shares and the resulting shares

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are sold within 12 months of exercise, and

- allowing the Taxation Commissioner to exercise discretion in relation to the minimum three-year holding period where there are circumstances outside the employee's control that make it impossible for them to meet this criterion.

There will also be a number of other amendments to the ESS rules. These changes will take effect with the remainder of the enabling legislation from July 1, 2015.

Research and development tax incentive

The government intends to introduce a $100 million cap on the amount of eligible research and development (R&D) expenditure for which companies can claim a tax offset at a concessional rate under the R&D tax incentive. Under the R&D tax incentive, companies with turnover of less than $20 million can claim a refundable tax offset of 43.5% and other companies can claim a non-refundable tax offset of 38.5%.

Expenditure beyond the $100 million cap will receive a lower offset at the company tax rate.

This measure replaces the measure announced by the previous government in the 2013-14 federal budget.

Managed investment trusts

The government announced its intention to introduce a 12 month transition period in the implementation of a new tax system for managed investment trusts (MITs). The provision of a transition period is a result of stakeholder feedback that many MITs require additional time to make amendments to their trust deeds and IT systems.

The new MIT rules will now apply from July 1, 2016. MITs will continue to be allowed to disregard the trust streaming provisions for the 2015-16 income year. However, MITs can choose to apply the new rules from July 1, 2015.

Streamlining business registration

The government will provide $32.4 million over five years from 2014 15 (including capital of $13.5 million over three years from 2014 15) for the Tax Office, Australian Securities and Investments Commission (ASIC) and the Department of Industry and Science, to:

- develop a single online portal for business and company registration
- publish new computer code to enable developers to build new registration software, and
- reduce the number of business identifiers.

Funding for this proposal is contingent on a second pass business case.

Crowd sourced equity funding for public companies

The government will provide $7.8 million over four years from 2015 16 to ASIC to implement and monitor a regulatory framework to facilitate the use of crowd sourced equity funding (CSEF), including simplified reporting and disclosure requirements.

According to the government, CSEF is an emerging form of funding that allows entrepreneurs to raise funds online from a large number of small investors and has the potential to increase funding options available for entrepreneurs to assist in the development of their business.

The proposed law will also remove the costly elements of transitioning to a public company, enabling proprietors of private companies to more easily raise funds from a large number of small investors.

Tax administration

Serious Financial Crime taskforce

The government announced that it will provide $127.6 million over four years to a "serious financial crime taskforce" for investigations and prosecutions that will address superannuation and investment fraud, identity crime and tax evasion.

The aim of the taskforce is to maintain integrity and community confidence in Australian financial markets and regulatory systems. The taskforce includes eight federal agencies, including the Tax Office.

Increase in value of penalty unit

The value of all Commonwealth penalty units will increase from $170 to $180 from July 31, 2015. The government will also introduce ongoing indexation of penalty units based on the CPI. Indexation will occur on July 1 every three years, with the first indexation occurring in 2018.

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Goods and services tax

GST on imported digital products and services

The government intends to extend the application of the GST to cross border supplies of digital products and services imported by Australian consumers (such as a Netflix Australia subscription).

Under the current GST law, these imports are not subject to the GST. According to the government, this places domestic businesses, which generally have to remit GST on the digital products and services they provide, at a tax disadvantage compared to foreign businesses.

This measure will result in Australia being an early adopter of guidelines for business-to-consumer supplies of digital products and services being developed by the OECD as part of the OECD/G20 base erosion and profit shifting project. The proposed measure will apply from 1 July 2017.

Note: This change will require the unanimous agreement of the states and territories prior to the enactment of legislation.

Fringe benefits tax

Cap for salary sacrificed meal entertainment and entertainment facility leasing expenses

The government will introduce a separate single grossed up cap of $5,000 for salary sacrificed meal entertainment and entertainment facility leasing expenses (meal entertainment benefits) for employees. Meal entertainment benefits exceeding the separate grossed up cap of $5,000 can also be counted in calculating whether an employee exceeds their existing FBT exemption or rebate cap. All use of meal entertainment benefits will become reportable.

Currently, employees of public benevolent institutions and health promotion charities have a standard $30,000 FBT exemption cap (this will be $31,177 for the first year of the measure, due to the Temporary Budget Repair Levy) and employees of public and not for profit hospitals and public ambulance services have a standard $17,000 FBT exemption cap (this will be $17,667 for the first year).

In addition to these FBT exemptions, these employees can salary sacrifice meal entertainment benefits with no FBT payable by the employer and without it being reported. Employees of rebatable not for profit organisations can also salary sacrifice meal entertainment benefits, but the employers only receive a partial FBT rebate, up to a standard $30,000 cap ($31,177 for the first year). This measure will apply from April 1, 2016.

Superannuation

In the 2015-16 federal budget, the government reiterated that it will not introduce any new superannuation taxes during this term of government. Accordingly, no new superannuation measures were announced, including any changes to the limited recourse borrowing arrangements.

The budget does however include certain marginal measures that were previously advised:

- Early super access for terminal illness: For those with a terminal medical condition, from July 1, 2015 the life expectancy period for full access to superannuation benefits to be extended from 12 to 24 months.
- Defined benefit super schemes: Commencing January 1, 2016 a 10% cap will be applied to the deductible amount of defined benefit income streams for the social security income test.
- Supervisory levies: These will be increased to allow full cost recovery from 2015-16.
- Lost and unclaimed superannuation: The reporting obligations will be streamlined from July 1, 2016.

Pensions

The budget confirmed a number of measures affecting pensions that were previously announced.

(i) Rebalance asset test thresholds and taper rate

The government intends to increase the asset test thresholds and the withdrawal rate at which pensions are reduced once the threshold is exceeded.

Asset test thresholds

The assets test threshold ("assets free area") will be increased:

- for single home owners – from $202,000 to $250,000
- for couple home owners – from $286,000 to $375,000.

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- Pensioners who do not own their own home will also see an increase in their threshold to $200,000 more than homeowner pensioners:
- for single non-home owners: $450,000, and
- for couple non-home owners: $575,000.

The government will also reduce the maximum value of assets that can be held to qualify for a part pension. For couples, this is currently up to $1,151,500 plus the family home. Under the proposed changes, this threshold will decrease to $823,000 plus the family home.

Note however that pensioners who lose pension entitlement on January 1, 2017 as a result of these changes will automatically be issued with a Commonwealth Seniors Health Card or a Health Care Card for those under Age Pension age.

Taper rates

The proposal will reverse changes to the “taper rates” introduced in 2007. From 1993 to 2007 a $3 taper rate was in place where for every additional $1,000 in assets above the minimum threshold for a full pension, fortnightly payments were reduced by $3. In 2007, this was changed to a $1.50 taper rate.

Taxpayers impacted by these changes will be able to maintain their current level of income by drawing down less than 1.84% on their additional assets ($574,000 for a single homeowner), in a worst case scenario. These measures will apply from 1 January 2017.

(ii) Improve integrity of social security income test arrangements

The government will improve fairness and equity in social security payments by ensuring that a larger proportion of a superannuant’s actual defined benefit income is taken into account when applying the relevant social security income test.

Under this measure, the proportion of income that can be excluded from any income test (the deductible amount) will be capped at 10% from January 1, 2016.

Under current arrangements, some defined benefit superannuants are able to have a large proportion of their superannuation income excluded from the pension income test.

Recipients of Veterans’ Affairs pensions and/or defined benefit income streams paid by military superannuation funds are exempt from this measure.

(iii) Not proceeding with elements of the measure to maintain eligibility thresholds for Australian Government payments for three years

The Government will not proceed with elements of the 2014 15 Budget measure Maintain eligibility thresholds for Australian Government payments for three years that relate to the pension income test free areas and deeming thresholds.

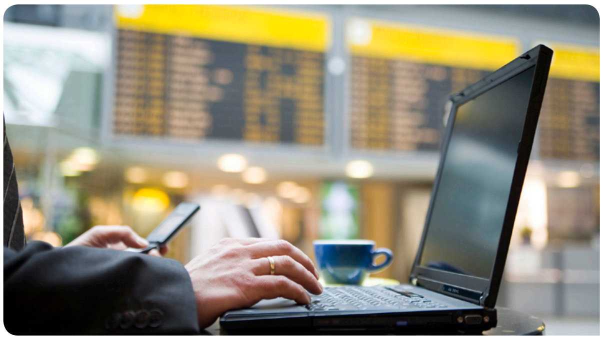
The pension income test free areas and deeming thresholds will continue to be indexed annually by the CPI. Major pension related payments include the Age Pension, Carer Payment, Disability Support Pension, and the Veterans’ Service Pension.

(iv) Pension indexation to CPI will not proceed

The government announced that it will not proceed with the 2014-15 budget measure to constrain increases in the pension to the CPI.

Pension and pension equivalent payment rates will continue to be indexed under current arrangements — by the higher of the increases in the CPI or the Pensioner and Beneficiary Living Cost Index and benchmarked against Male Total Average Weekly Earnings.

International tax



Tax residency rules for temporary working holiday makers

The government intends to change the tax residency rules so that most people who are temporarily in Australia for a working holiday as non-resident for tax purposes, regardless of how long they are in Australia, will continue to be taxed as a non-resident.

As a result, affected taxpayers will be taxed at 32.5% from their first dollar of taxable income.

Under the current tax residency rules, a working holiday maker can be treated as a resident for tax purposes if they satisfy the residency tests; typically, that they are in Australia for more than six months.

This means that currently these taxpayers are able to access resident tax treatment, including the tax-free threshold of $18,200, the low income tax offset and the lower marginal tax rate of 19% for taxable incomes between $18,201 and $37,000. The measure will apply from July 1, 2016.