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Federal Budget 2018: Tax cuts, responsible spending and back to surplus

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In his third budget, Treasurer Scott Morrison delivered what is widely considered to be an election budget reporting a budget deficit for 2017-18 of $18.2b (less than half of what it was 2 years ago) and purporting a further fall to $14.5b in 2018-19 with a modest surplus projected of $2.2b by 2019-20. The Budget expects real GDP to grow at 2.75% in 2017-18 and 3.0% in 2018-19 (as was forecast in the 2017-18 budget), which should continue to lower the unemployment rate over the coming years.

But what about the specific measures that will impact you? With so much change to superannuation over the past two years, could there possibly be anymore? Well, yes, but generally positive, including a limited rollback of the work test! There have been positive announcements regarding release of 14,000 extra high level homecare packages, but for social security recipients, all the pre-budget speculation of a rise in the Newstart Allowance didn't happen. The centrepiece of the Government's announcement is no doubt the focus on personal and small business taxation with much of the Treasurer's second reading speech concentrating on personal income tax reductions. In this special federal budget edition of Financial Insights, we have listed the main proposals of the 2018 Federal Budget, commenting on those measures which most impact upon your financial journey.

Summary of revenue measures announced

As mentioned, the Government's key announcement is a major 7-year 3-step plan to reform personal income tax which is described below. Before we get into that, following is a summary of the key revenue measures announced which interestingly include a variety of measures that also target trusts, cash payments and some deductions;

- Staged personal tax reform over 7 years from 2018-19, including new low income tax offset
- Super Guarantee opt-out for high-income employees who breach concessional cap
- Personal superannuation contributions - improving notice of intention to deduct
- SMSF audit cycle of 3 years for funds with good compliance history
- Super fees to be capped at 3% for small accounts, exit fees banned.
- Extending the $20,000 instant asset write-off by another 12 months
- Application of Div 7A to UPEs clarified
- No tax deduction for non-compliant PAYG and contractor payments
- Cash payments limit of $10,000 for payments made to businesses and other measures to target the black economy
- Minors and testamentary trusts - concessional tax rates limit
- Anti-avoidance rules introduced to target family trust circular distributions
- Deductions disallowed for holding vacant land
- Removing the CGT discount at trust level for MITs and AMITs

Personal Tax Measures

Personal tax rates: staged 7-year reform plan

In the 2018-19 Budget, the Government announced staged tax relief for low and middle income earners. The Government is proposing a major 7-year 3-step plan to reform personal income tax.

- **Step 1** will see a new non-refundable low and middle income tax offset from 2018-19 to 2021-22.
- **Step 2** will increase the top threshold of the 32.5% tax bracket from $87,000 to $90,000 from 1 July 2018. In 2022-23, the top threshold of the 19% bracket will increase from $37,000 to $41,000. The top threshold of the 32.5% bracket will increase from $90,000 to $120,000 from 1 July 2022.
- **Step 3** - from 1 July 2024, the top threshold of the 32.5% bracket will increase from $120,000 to $200,000, removing the 37% tax bracket completely.

The Treasurer announced that implementation of these measures will mean that around 94% of all taxpayers are projected to face a marginal tax rate of 32.5% or less in 2024-25.

Tax rates and thresholds for 2018-19 onwards

The following table reflects the Government's announced personal tax rate and threshold changes (highlighted in **bold**), excluding the 2% Medicare levy:

Tax rates and thresholds			
Rate	**2018-19 to 2021-22**	**2022-23 and 2023-24**	**2024-25 onwards**
0%	$0 - $18,200	$0 - $18,200	$0 - $18,200
19%	$18,201 - $37,000	$18,201 - $41,000	$18,201 - $41,000
32.5%	$37,001 - $90,000	$41,001 - $120,000	$41,001 - $200,000
37%	$90,001 - $180,000	$120,001 - $180,000	-
45%	$180,001+	$180,001+	$200,001+

Tax rates and thresholds for 2017-18 unchanged

The rates for the 2017-18 year (excluding the 2% Medicare levy) remain unchanged and are:

2017-18	
Taxable income ($)	Tax payable ($)
0 - 18,200	Nil
18,201 - 37,000	Nil + 19% of excess over 18,200
37,001 - 87,000	3,572 + 32.5% of excess over 37,000
87,001 - 180,000	19,822 + 37% of excess over 87,000
180,001+	54,232 + 45% of excess over $180,000

The Government had originally proposed to increase the Medicare levy from 2% to 2.5% from 1 July 2019 to help fund the NDIS but has decided not to proceed with this stating that all planned expenditure on the NDIS will be able to be met in this year's Budget and beyond without any longer having to increase the Medicare levy.

Low income tax offset

The currently legislated low income tax offset (LITO) rates will not change for 2017-18 and are:

- LITO amount - $445.
- Lower withdrawal limit - $37,000.
- Upper withdrawal limit - $66,667.
- Withdrawal rate - 1.5%.

Foreign residents

The unchanged tax rates for foreign residents for 2017-18 are:

2017-18	
Taxable income $	**Tax payable $**
0 - 87,000	32.5%
87,001 - 180,000	28,275 + 37% of excess over 87,000
180,001+	62,685 + 45% of excess over $180,000

Foreign residents are not liable to pay the Medicare levy.

Medicare levy low-income thresholds for 2017-18

For the 2017-18 income year, the Medicare levy low-income threshold for singles will be increased to $21,980 (up from $21,655 for 2016-17). For couples with no children, the family income threshold will be increased to $37,089 (up from $36,541 for 2016-17). The additional amount of threshold for each dependent child or student will be increased to $3,406 (up from $3,356).

For single seniors and pensioners eligible for the SAPTO, the Medicare levy low-income threshold will be increased to $34,758 (up from $34,244 for 2016-17). The family threshold for seniors and pensioners will be increased to $48,385 (up from $47,670), plus $3,406 for each dependent child or student.

Date of effect

The increased thresholds will apply to the 2017-18 and later income years. Note that legislation is required to amend the thresholds and a Bill will be introduced shortly.

Source: Budget Paper No 2 [p 32]

Superannuation Measures

SMSF & Small APRA Fund Member Limit

It has been confirmed that from 1 July 2019, the maximum number of members allowed in SMSF's and Small APRA funds (both new and existing) will increase from 4 to 6. This will provide greater flexibility for larger families to manage their retirement savings.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 40]

Personal Deductible Superannuation Contributions – Improving the Notice of Intention to Deduct

From 1 July 2018, the Government has announced measures designed to improve the process of claiming tax deductions for personal contributions to superannuation. Currently, there are individuals claiming the deduction without submitting a notice of intent. In addition to receiving the tax deduction, no contributions tax is paid on the contribution. The measures include funding for the ATO to develop a new compliance model and undertake further debt collection activities, and tax returns will be modified to include a mechanism for an individual to confirm they have complied with the requirement to submit a Notice of Intent.

Date of effect

1 July 2018.

Source: Budget Paper No 2 [p 39]

Work Test Exemption

From 1 July 2019, an exemption to the work test will be introduced for those aged 65-74 with super balances below $300,000. These individuals will be able to make voluntary superannuation contributions in the first year they do not meet the work test, allowing retirees increased flexibility in getting their finances in order.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 30]

Super Guarantee Opt Out for High Income Earners

From 1 July 2018, those with an income exceeding $265,157 and have multiple employers will be able to nominate wages not subject to SG to reduce the risk of inadvertently breaching the concessional contributions cap. Employees in this situation may be able to negotiate additional income, taxed at their MTR instead.

Date of effect

1 July 2018.

Source: Budget Paper No 2 [p 40]

SMSF Audit Cycle

The requirement for SMSF's to undergo annual audits will be extended to a three yearly cycle for funds with a good compliance and record keeping history (trustees must have a history of 3 consecutive years of clear audit reports, and all documents have been lodged on time). This is expected to take effect from 1 July 2019, with consultation to take place to ensure the transition process runs smoothly.

Date of effect

Following a period of consultation that Government expects this measure will start on 1 July 2019.

Source: Budget Paper No 2 [p 41]

Protecting your Super Package

With the aim of ultimately increasing Australians' superannuation balances, from 1 July 2019, a number of measures will be introduced to help protect people's retirement savings from undue erosion. These measures include:

A **3% annual cap on passive fees** charged by superannuation funds will be introduced for accounts with a balance below $6,000. Exit fees will also be banned on all superannuation accounts.

The **consolidation regime will also be strengthened**, with the requirement to have all accounts with a balance below $6,000 transferred to the ATO. Data matching processes will be expanded in an attempt to proactively reunite inactive accounts with a member's active account. This will also include the payment of funds already held by the ATO.

The Government will also make changes to insurance arrangements for those with account balances below $6,000, members under the age of 25 and members of inactive accounts where no contributions have been received for 13 months. In these cases, insurances will move from a default framework and be offered on an opt in basis. A timeframe of 14 months will be provided for existing members in these situations to either opt in or 'switch off' their cover.

Date of effect

1 July 2019.

Exposure draft legislation to give effect to the Government's *Protecting Your Super Package* measures has been released on the Treasury Website. Submissions are due by 29 May 2018.

Source: Budget Paper No 2 [p 35]; Minister for Revenue and Financial Services, media release, 8 May 2018

Trustees required to Formulate Retirement Income Strategy

The SIS act will be amended to include a requirement requiring superannuation fund trustees to formulate retirement income strategies for members, alongside the existing requirements to formulate, and regularly review an investment strategy and insurance strategy. No effective date has been specified for this measure.

Date of effect

Not specified.

Source: Budget Paper No 2 [p 185]

A note on super borrowings - no Budget changes to LRBAs but restrictions growing

LRBA flexibility from increased SMSF members

While the Budget did not reveal any direct changes for LRBAs, the proposal to increase the maximum number of SMSF members from 4 to 6 should provide some additional flexibility around the use of LRBAs. Given the reduced contribution caps and restrictions from 1 July 2017, the ability to include an extra 2 members within a SMSF may assist in managing the fund's cash flow in relation to an LRBA. Adding extra SMSF members could also help the fund to put together a deposit for direct property, given that LRBA lenders typically require a loan-to-value ratio below 70%.

Caution required amid growing restrictions for LRBAs

Draft legislation has proposed to include a member's share of any outstanding LRBA (entered from 1 July 2018) in their "total superannuation balance" (TSB). This 2017-18 Budget measure (yet to be legislated as at 8 May 2018) will also effectively curtail the future use of LRBAs for some individuals. Those with a TSB of $1.6m or more are now also prevented from making further non-concessional contributions, so this proposed measure would effectively restrict the future use of large LRBAs (or at least require more sophisticated contributions planning to address the extra complexity over the life of a LRBA).

Social Security Measures

Measures to assist older Australians

From 1 July 2019, the pension work bonus will be increased from $250 to $300 per fortnight, and will also be extended to the self-employed.

The pension means testing rules will also be amended to encourage the development and uptake of lifetime retirement income products with the aim of managing the risk of people outliving their retirement savings.

We note that a final decision on the social security treatment of the new category of tax-exempt pooled lifetime retirement income streams is yet to be made. The social security treatment for these lifetime retirement income streams and deferred lifetime annuities will be crucial to their take up by retirees.
Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 175]; Treasurer media release 8 May 2018

Other Social Security Measures

The Government has also announced other measures, including:

- Extending fraud detection and debt recovery activities. The integrity of payments will also be enhanced by extending data matching with the ATO.
- ABSTUDY reforms for secondary students aimed at improving educational opportunities for indigenous secondary school students.
- The alignment of eligibility for student payments for higher education courses with eligibility for the Higher Education Loan Program (HELP).
- Reducing the maximum suspension period for imprisoned Disability Support Pension recipients from 2 years to 13 weeks, in line with other income support payments such as Newstart.
- The introduction of a $250,000 income test threshold to Carer Allowance in order to fund carer support services.

Access to Youth Allowance will be improved for regional students and thresholds and assessment years for parental income will change.

Business Tax Measures

$20,000 instant asset write-off for SBEs extended by 12 months

The Government will extend the current instant asset write-off ($20,000 threshold) for small business entities (SBEs) by 12 months to 30 June 2019. This applies to businesses with aggregated annual turnover less than $10 million.

The threshold amount was due to return to $1,000 on 1 July 2018. As a result of this announcement, SBEs will be able to immediately deduct purchases of eligible depreciating assets costing less than $20,000 that are acquired between 1 July 2017 and 30 June 2019 and first used or installed ready for use by 30 June 2019 for a taxable purpose. Only a few assets are not eligible for the instant asset write-off (or other simplified depreciation rules), eg horticultural plants and in-house software.

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the general small business 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).

The current 'lock out' laws for the simplified depreciation rules (these prevent small businesses from re-entering the simplified depreciation regime for 5 years if they opt out) will continue to be suspended until 30 June 2019.

The instant asset write-off threshold and the threshold for immediate deductibility of the balance of the pool will revert to $1,000 on 1 July 2019.

Source: Budget Paper No 2, p 20

Partnerships: enhancing integrity of concessions

Partners that alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership will no longer be able to access the small business capital gains tax (CGT) concessions in relation to these rights.

The Government said this measure will prevent taxpayers, including large partnerships, inappropriately accessing the CGT small business concessions in relation to their assignment to an entity of a right to the future income of a partnership, without giving that entity any role in the partnership.

There are no changes to the small business CGT concessions themselves. The concessions will continue to be available to eligible small businesses with an aggregated annual turnover of less than $2 million or net assets less than $6 million.

Date of effect

8 May 2018.

Source: Budget Paper No 2 [p 43]

No tax deduction for non-compliant PAYG and contractor payments

Measures will be enacted to ensure that taxpayers will not be able to claim deductions for payments to their employees such as wages where they have not withheld any amount of PAYG from these payments, despite the PAYG withholding requirements applying.

Similarly, the Government intends to remove deductions for payments made by businesses to contractors where the contractor does not provide an ABN and the business does not withhold any amount of PAYG (again despite the withholding requirements applying).

This was recommended by the Black Economy Taskforce.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 24]

Additional funding for Single Touch Payroll to assist small businesses

The Government will provide an addition $15 million over 3 years from the 2018-19 income year to the ATO to support the modernisation of payroll and superannuation fund reporting. The funding will be used to support small businesses with fewer than 20 employees during the transition to Single Touch Payroll Reporting from 1 July 2019.

Source: Budget Paper No 2 [p 185]

Deductions disallowed for holding vacant land

The Government will disallow deductions for expenses associated with holding vacant land. Where the land is not genuinely held for the purpose of earning assessable income, expenses such as interest costs will be denied. It is hoped this measure will reduce the tax incentives for land banking which limit the use of land for housing or other development.

The measure will apply to both land held for residential and commercial purposes. However, the "carrying on a business" test would generally exclude land held for a commercial development. It will not apply to expenses associated with holding land that are incurred after:

- a property has been constructed on the land, it has received approval to be occupied and available for rent; or
- the land is being used by the owner to carry on a business, including a business of primary production.

Disallowed deductions will not be able to be carried forward for use in later income years. Expenses for which deductions will be denied could be included in the cost base if it would ordinarily be a cost base element (ie borrowing costs and council rates) for CGT purposes. However, if the denied deductions are for expenses would not ordinarily be a cost base element, they cannot be included in the cost base.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 42]

Measures affecting trusts

Minors and testamentary trusts: Concessional tax rates limit

The concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets that are transferred from deceased estates or the proceeds of the disposal or investment of those assets. Currently, income received by minors from testamentary trusts is taxed at normal adult rates rather than the higher tax rates that generally apply to minors.

The Government is concerned that some taxpayers are able to inappropriately obtain the benefit of this lower tax rate by injecting assets unrelated to the deceased estate into testamentary trusts. This measure will clarify that minors will be taxed at adult marginal tax rates only in relation to income of a testamentary trust that is generated from assets of a deceased estate (or the proceed of the disposal or investment of these assets).

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 44]

Family trust circular distributions – new anti-avoidance rules

The Government will extend specific anti-avoidance rules that applies to other closely held trusts that engage in circular trust distributions to family trusts.

Currently, where family trusts act as beneficiaries of each other in a round robin arrangement, a distribution can ultimately be returned to the original trustee in a way that avoids any tax being paid on that amount. The measure will allow ATO to pursue family trusts that engage in these arrangements and impose tax on such distributions at a rate equal to the top personal rate plus the Medicare levy.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 43]

Application of Div 7A to UPEs

The Government will clarify the operation of Div 7A of the ITAA 1936 to ensure that unpaid present entitlements (UPEs) come within the scope of Div 7A. A UPE arises where a related private company becomes entitled to a share of trust income as a beneficiary but has not been paid that amount.

Division 7A requires benefits provided by private companies to related taxpayers to be taxed as dividends unless they are structured as Div 7A complying loans or another exception applies. This measure will ensure the UPE is either required to be repaid to the private company over time as a complying loan or subject to tax as a dividend.

Date of effect

Including the measures announced in the 2016-17 Budget which will mean all the Div 7A amendments will form part of a consolidated package, these measures will apply from 1 July 2019

Source: Budget Paper No 2 [p 41]

Other Measures

Increased compliance activities: individuals and their tax agents

The Government will provide $130.8 million to the ATO from 1 July 2018 to increase compliance activities targeting individuals and their tax agents. This measure stems from the ATO identifying a number of significant compliance issues for individual taxpayers which results in a significant loss of revenue for the Government each year.

The extra funding will continue 4 income matching programs that would have been otherwise terminated from 1 July 2018 to allow the ATO to detect incorrect reporting of income such as foreign sourced income of high wealth individuals. The funding will also allow for new compliance activities including additional audits and prosecutions, improving education and guidance materials, pre-filling of income tax returns, and improving real time messaging to tax agents and individual taxpayers to deter over-claiming of entitlements, especially in relation to higher risk taxpayers and their agents.

Date of effect

1 July 2018

Source: Budget Paper No 2 [p 31]

MITS and AMITs: removing CGT discount at trust level

Managed Investment Trusts (MITs) and Attribution MITs (AMITs) will be prevented from applying the 50% capital gains discount at the trust level. This measure will prevent beneficiaries that are not entitled to the CGT discount in their own right from getting a benefit from the CGT discount being applied at the trust level.

This will ensure that MITs and AMITs operate as genuine flow through tax vehicles, so that income is taxed in the hands of investors, as if they had invested directly. Under the measure, MITs and AMITs that derive a capital gain will still be able to distribute this income as a capital gain that can be discounted in the hands of the beneficiary.

Date of effect

1 July 2019.

Source: Budget Paper No 2 [p 44]

Cash payments limit: payments made to businesses

The Government will introduce a limit of $10,000 for cash payments made to businesses for goods and services.

This measure will require transactions over a threshold to be made through an electronic payment system or by cheque. Logically it would seem that this threshold amount should be $10,000, but this is not spelt out in the Budget papers or the media release.

The rules will not apply to transactions with:

- financial institutions; or
- consumer-to-consumer non-business transactions.

This measure was recommended by the Black Economy Taskforce. It is designed to support other measures designed to counter the black economy. There is no revenue impact associated with it.

Date of effect

Following a period of consultation, the limit is expected to apply from 1 July 2019.

Source: Budget Paper No 2 [p 23]; Minister for Revenue media release, 8 May 2018

Royal Commission into Banking

$10.6 Million over two years will be provided to ASIC, and $2.7 Million in 2018/19 to APRA to assist in their involvement in the Royal Commission into misconduct in the banking, superannuation and financial services industry.

Conclusion

As most anticipated, it was what is termed an 'election budget'. No major changes, as there had been in their previous budgets.

Apart from tax cuts, a limited unwinding of the work test, the promise of improvements to the notice of intent to claim a deduction, continuation of the instant asset write-off for small businesses and bigger SMSFs, and more tax office compliance, there was not a lot in this budget.

There seemed to be a bigger focus on infrastructure and preserving Australia's AAA credit rating.

If you have questions on the measures included in this year's budget, or how any of the proposed changes are likely to affect you, please speak to your adviser and/or tax professional.

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