



Federal Budget 2017-18

The Budget announcements contain a suite of tax and superannuation measures aimed at increasing housing stock and improving housing affordability. While the government has not gone close to clamping down on the political and social hot potato of negative gearing, it has taken some steps to restrict the travel expense and depreciation tax breaks enjoyed by investors.

About this newsletter

Welcome to TWF Partners' client information newsletter. We trust it will assist you in keeping up to date on tax related issues and changes. Should you require further information on any topics covered please contact us via the details below.

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Significantly, curtailing these deductions only applies to residential properties and not commercial properties. And again, these are measures to help Australians who aspire to own their own home compete against investors.

The government's higher education reform package was widely discussed in the lead up to budget night. On the tax front, as predicted, HELP debt repayment thresholds have been lowered significantly. This news will not be pleasing to current, recent and prospective tertiary students, especially in an era of low wage growth and high housing prices. On the education front, the government also committed extra funding for schools.

Federal Budget 2017 cont

Infrastructure and health initiatives are staples of every federal budget and this year is no different. As usual, with large-scale national interest commitments, the government giveth, and the government taketh away.

Last year, many individual taxpayers received small “cake and coffee” tax cuts (so called because they averaged around \$6) which were touted as an important first step to addressing bracket creep.

But one year later, the government announces that the Medicare Levy will increase to 2.5%, which will surely eat into those tax cuts (for those lucky enough to have received them). The higher Medicare Levy will go towards funding the NDIS and a new Medicare Guarantee Fund.

Last year’s Budget was one for small businesses. This year, the small gift is a one year extension of the \$20,000 instant asset write-off for 2017-18. Unfortunately, the government will tighten access to the small business CGT concessions. For larger businesses, the government will again try valiantly to push the rest of its 10-year company tax cut plan through a Senate that was unwilling to give those tax cuts to companies with turnovers exceeding \$50 million a mere 6 weeks ago.

In a non-election year, there have not been too many sweeteners, but a focus on balancing the budget. The attempts to improve housing affordability are certainly to be applauded – time (and housing prices) will tell whether they hit their mark. ■



FEDERAL BUDGET 2017:

Individuals

Medicare levy will increase from 2% to 2.5%

The Medicare levy will increase by 0.5% from 2019-20 to ensure that the National Disability Insurance Scheme (NDIS) is fully funded. Other tax rates that incorporate the top personal tax rate, such as the FBT rate, will also increase.

The increase in the Medicare levy will swallow the benefits from last year’s tax cuts for individuals with taxable incomes exceeding \$80,000. The increase however has been pushed out to beyond the next federal election.

Medicare levy low-income thresholds increase

The Medicare levy low-income thresholds will increase from 2016-17 (see table below). The increase in the low-income thresholds will provide some relief for lower income earners from the across-the-board 0.5% increase to the Medicare levy that will commence in 2019-20. Ideally, the government will increase the thresholds in line with economic growth or wage growth so that affected taxpayers are not disadvantaged over the years.

	Current threshold	Threshold in 2018-19
Single	\$21,335	\$21,655
Family	\$36,001	\$36,541 (plus \$3,356 for each dependent child)
Single seniors and pensioners	\$33,738	\$34,244
Senior and pensioners family	\$46,966	\$47,670 (plus \$3,356 for each dependent child)

Federal Budget 2017: Individuals cont

HELP debt repayments

From 1 July 2019, the indexation of the Higher Education Loan Program (HELP) repayment thresholds, currently linked to Average Weekly Earnings (AWE), will be changed to align to the Consumer Price Index (CPI). The new thresholds and rates apply from 2018-19, and the indexation of HELP repayment thresholds to CPI from 2019-20. See table below.

This measure is part of the government's Higher Education Reform Package. Overall, the proposal to reduce repayment thresholds by almost \$14,000 will not be welcomed by current university students, high school students who aim to study at university, and former students who are still bearing a HELP debt. The reduction of the minimum repayment rate from 4% to 1% may not offer sufficient relief from the change in thresholds.

Changed HELP thresholds & repayment rates

	Current (2017-18)	Proposed (2018-19)
Minimum repayment threshold (taxable income)	\$55,874	\$42,000
Minimum repayment rate (applies to minimum repayment threshold)	4%	1%
Maximum repayment rate	8% (from \$107,214)	9.5% (from \$100,655)

Family Tax Benefit Part A

The government will reduce Family Tax Benefit (FTB) Part A supplement payments by \$28 per fortnight for each child who does not meet immunisation requirements. The government will also implement a consistent 30 cents in the dollar income test taper for FTB Part A families with a household income in excess of the Higher Income Free Area (currently \$94,316).

The measure will apply for the supplement payments from 2017-18, and the income test taper from 2018-19.

The FTB Part A supplement payment announcement is aimed at discouraging parents from not immunising their children. The income test taper proposal ensures that higher income families are subject to the same income test taper rates. ■



FEDERAL BUDGET 2017:

Housing

Travel expenses relating to residential rental properties

The government will disallow deductions for travel expenses related to inspecting, maintaining or collecting rent for a residential rental property. The measure is to apply from 2017-18.

This seems to be an integrity measure put in place by the ATO to address concerns that many rental

property owning taxpayers have been claiming travel deductions without correctly apportioning costs, or have claimed travel costs that in reality were for private travel purposes.

However this measure will not prevent property investors from engaging third parties such as real estate agents for property management services and other related services. These expenses will still be deductible as is the position now.

Federal Budget 2017: Housing *cont*

Restricting rental property depreciation deductions

Currently, investors who purchase plant and equipment for a residential investment property are able to claim a deduction over the effective life of the asset. However under this measure subsequent owners of the property will be unable to claim deductions for the plant and equipment purchased by the previous owner.

Plant and equipment purchased on or before 9 May 2017 will continue to give rise to deductions for depreciation until either the investor (which may include a subsequent owner) no longer owns the asset, or the asset reaches the end of its effective life. But contracts entered into after budget night (specifically 7.30pm (AEST) on 9 May 2017) fall under the new rules.

This proposal is one of a suite of budget measures intended to improve housing affordability for owner-occupiers. While the government has stopped far short of restricting negative gearing, by limiting the ability of residential property investors to claim depreciation deductions for plant purchased by a former owner of the property, it is limiting the tax breaks enjoyed by investors.

Acquisitions of existing plant and equipment items will be reflected in the cost base for capital gains tax purposes for subsequent investors.

Foreign and temporary residents – main residence exemption

Foreign and temporary tax residents will not be able to claim the main residence CGT exemption from budget night (that is, from 7:30pm AEST on 9 May 2017). Existing properties held before this date will be grandfathered until 30 June 2019.

Foreign and temporary residents may currently utilise the absence rule in the CGT main residence exemption provisions to claim the main residence exemption on an Australian property even if they are not residing in it. They can use the rule for up to six years if they are renting out the property, or indefinitely if they are not deriving income from the property.

These taxpayers will now be subject to CGT on the sale of real property that they claim as their main residence. In other words, the CGT main residence exemption will not apply.

Affected foreign and temporary residents may need to contemplate selling their property by 30 June 2019 if they wish to realise the increase in value without attracting Australian income tax.

Foreign resident CGT withholding

The government will make the following changes to the foreign resident CGT withholding rules:

- the withholding rate will increase from 10% to 12.5% from 1 July 2017, and
- the withholding threshold will be lowered from \$2 million to \$750,000 from 1 July 2017.

Currently a non-final withholding tax applies to sales of real property by non-residents for tax purposes. The current withholding tax rate is 10% of proceeds of sale and applies to real property transactions with a market value of \$2 million or more.

The budget measure proposes to increase the withholding tax rate from 10% to 12.5% and lower the transaction value threshold from \$2 million to \$750,000.

The large reduction in the threshold will especially affect property vendors and purchasers in Australia's large capital cities. The sales of many more family homes will be affected by the \$750,000 threshold than by the current \$2 million threshold.

Purchasers of these properties must withhold the relevant amount at settlement and pay it to the ATO without delay (the general interest charge may apply to late payments). The penalty for failing to withhold is equal to the amount that was required to be withheld and paid.

It is also the responsibility of the purchaser to check whether a withholding obligation exists (that is, whether the vendor is likely to be non-resident). The reduction of the threshold will require many more buyers of family homes to play the role of tax collector.

A resident vendor needs to receive a clearance certificate from the ATO to ensure that withholding is to apply. Again, the reduction of the threshold creates extra administrative burden. ■



FEDERAL BUDGET 2017:

Business

\$20,000 instant asset write-off

The \$20,000 instant asset write-off will be extended for another 12 months until 30 June 2018. This was due to revert to \$1,000 on 1 July 2017.

Under this measure, small businesses (with aggregated turnovers of less than \$10 million) will be able to immediately deduct purchases of eligible assets costing less than \$20,000 first used or installed ready for use by 30 June 2018.

The business community has been asking for the \$20,000 write-off to remain permanently. Although the extension of one year is less than what most business owners would prefer, it is nevertheless a good step.

The annual aggregated turnover threshold to access this concession has also been increased from \$2 million to \$10 million from 2016-17. The threshold increase along with this Budget announcement means that many more businesses will be able to access this concession than in previous years.

Assets costing \$20,000 or more can continue to be placed into the simplified depreciation pool and depreciated at 15% for the first income year and 30% for each income year afterwards. The pool balance can also be immediately deducted if it reduces to less than \$20,000 during this period.

Small business CGT concessions

The government will amend the small business CGT concessions to ensure that the concessions can only be accessed in relation to assets used by a small business or ownership interests in a small business.

The concessions assist owners of small businesses by providing relief from CGT on assets related to their business that help them to re-invest and grow, as well as contribute to their retirement savings through the sale of the business.

The measure, with application from 2017-18, will affect taxpayers:

- that are small businesses with annual aggregated turnover of less than \$2 million, or
- whose asset was used in a connected small business, or
- who have a maximum net asset value not exceeding \$6 million.

However without legislative detail being available, it is a little unclear as to whether the measure will result in:

- the concessions becoming unavailable in relation to passively held assets, or
- the concessions only being available in relation to passively held assets if both parties are small businesses.

In either case, it would appear that this measure will have the effect of restricting the availability of the small business CGT concessions. This is disappointing, especially with the turnover threshold remaining at \$2 million while the threshold for all other small business concessions increased to \$10 million or \$5 million from 2016-17.

Reintroducing the 10-year enterprise tax plan

In the 2016-17 budget, the government proposed a 10-year enterprise tax plan that included progressive tax cuts over 10 years for all companies until the corporate tax rate is 25% in 2026-17.

In late March 2017, Parliament passed legislation to give effect to these tax cuts – but only for companies that carry on a business and have an aggregated annual turnover of less than \$50 million.

The government has now announced its intention to reintroduce the rest of the original package. The following is the original enterprise tax plan for all companies.

Federal Budget 2017: Business *cont***From 2016-17 to 2022-23**

The initial 27.5% rate will be implemented progressively from 2016-17 to 2022-23 based on the company's annual aggregated turnover:

Annual aggregated turnover threshold	Income year in which the 27.5% rate applies
Less than \$10 million	2016-17
\$25 million	2017-18
\$50 million	2018-19
\$100 million	2019-20
\$250 million	2020-21
\$500 million	2021-22
\$1 billion	2022-23

From 2023-24 to 2026-27

Once all companies are at a rate of 27.5%, the rate will be progressively reduced to 25% in 2026-27:

Income year	Tax rate
2022-23 & 2023-24	27.5%
2024-25	27%
2025-26	26%
2026-27	25%

The government will try again to pass the corporate tax cuts for companies of all sizes. Given the reluctance by the current Senate and its amendments to the original package before it was passed for companies of less than \$50 million aggregated turnover, it would be unlikely that the tax cuts for larger companies will be passed anytime soon – unless the Government can offer a sweetener to dissenting Senators. ■

**FEDERAL BUDGET 2017:**

Superannuation

First Home Super Saver Scheme

Voluntary contributions to superannuation made by first home buyers from 1 July 2017 are going to be accessible for the purpose of a first home deposit. These voluntary contributions along with associated deemed earnings can be withdrawn. Withdrawals under the scheme are allowed from 1 July 2018.

The First Home Super Saver Scheme sets the limit on the amount of voluntary contributions that can be withdrawn for the purpose of a first home deposit – up to \$15,000 per financial year and \$30,000 in total over the taxpayer's lifetime. Both members of a couple can take advantage of this measure to buy their first home together.

The proposal affects taxpayers who will purchase their first home and have made *voluntary* contributions of any type:

- non-concessional contributions
- personal concessional contributions, and
- salary sacrificed contributions.

Note that mandatory employer contributions (currently at 9.5%) are not voluntary, and neither are contributions made under enterprise bargaining and similar agreements.

Note that this scheme does not allow any additional contributions to be made over and above the existing contribution caps.

Federal Budget 2017: Superannuation *cont*

Concessional contributions and deemed earnings that are withdrawn will be taxed at marginal rates less a 30% offset. Non-concessional contributions withdrawn under the scheme will not be taxed but the deemed earnings on these contributions will be subject to tax at marginal rates less a 30% offset.

Voluntary superannuation contributions made from 1 July 2017 will be eligible for this measure. Withdrawals will be allowed from 1 July 2018.

The amount of deemed earnings that can be released together with voluntary contributions will be calculated using a deemed rate of return based on the 90-day Bank Bill rate plus 3%. The rate for the June 2017 quarter, for example, is 4.78%.

The withdrawn amounts under the scheme will not affect social security benefits, such as the Family Tax Benefit, HECS/HELP or other benefits.

The measure essentially provides a concessional tax environment for saving of funds to be used for a first home deposit. Rather than saving for the first home from personal income taxed at 32.5% or 37%, taxpayers will be able to salary sacrifice their income into superannuation to be taxed at 15%.

For instance, a taxpayer on a 37% marginal income tax rate saves \$2,200 in tax by salary sacrificing \$10,000. Upon withdrawal for the first home deposit, this taxpayer will need to pay \$700 in tax (after the 30% offset) on the amount withdrawn. Therefore, the net benefit is \$1,500 compared to a situation when the deposit is saved using only after-tax dollars.

The cap for non-concessional contributions for the 2017-18 financial year is \$100,000. Only superannuation members with a total superannuation balance of less than \$1.6 million as on 30 June 2017 are able to make any non-concessional contributions in the 2017-18 income year. Non-concessional contributions are not taxed in the superannuation fund.

The cap for concessional contributions for 2017-18 is \$25,000. Individual taxpayers are able to deduct concessional contributions they made for themselves. This deduction however, cannot result in a tax loss for the year. Concessional contributions form part of taxable income of the superannuation fund that is subject to a 15% income tax rate.



Case study to explain the measure

Michelle earns \$60,000 a year and wants to buy her first home. Using a salary sacrifice arrangement established on 1 July 2017, she annually directs \$10,000 of pre-tax income into her superannuation account, increasing her balance by \$8,500 after the contributions tax of 15% has been paid by her fund.

After three years, she is able to withdraw \$27,380 of contributions and deemed earnings on those contributions:

3 years of \$10,000 salary sacrificed contributions after contributions tax of 15% (\$8,500 x 3) \$25,500

plus

deemed earnings on the above amount accrued over three years (at a rate of 90-day Bank Bill rate plus 3%) \$1,880

Michelle's withdrawal is taxed at her marginal rate (including Medicare levy) less a 30% offset.

After paying \$1,620 of withdrawal tax she has \$25,760 that she can use for her deposit. Michelle has saved around \$6,240 more for a deposit than if she had saved in a standard deposit account.

Michelle's partner Nick has the same income and also salary sacrifices \$10,000 annually to superannuation over the same period. Together they have \$51,520 that they can put towards a deposit, \$12,480 more than if they had saved in a standard deposit account.

Superannuation contributions from proceeds of downsizing

The government will allow a person aged 65 or over to make a non-concessional contribution of up to \$300,000 from the proceeds of selling their home (which they are to have owned for 10 years or more). Such contributions will be exempt from:

- the non-concessional contributions cap and \$1.6 million total superannuation balance test
- the work test
- the age test.

Therefore, taxpayers with a total superannuation balance in excess of the general transfer balance cap, set at \$1.6 million for 2017-18, as well as those over 65 and not working, and those aged over 75, will be able to make the proposed "downsizing" contribution of \$300,000.

Federal Budget 2017: Superannuation *cont*

Both members of a couple will be able to take advantage of this measure for the same home, meaning up to \$600,000 per couple can be contributed to superannuation through the downsizing cap. It will apply from 2018-19.

This proposal is part of the suite of Budget measures aimed at improving housing stock and affordability. This measure makes it easier for older people to sell their family homes after their children have moved out and downsize into a smaller property. The theory is that this will make more of these homes available for younger families to purchase.

Social security recipients, such as taxpayers receiving the Age Pension, should note that any change in the person's superannuation balance as a result of this measure will count towards the Age Pension assets test. This means that pensioners will need to evaluate the impact of the downsizing contribution on their eligibility for the Age Pension.

Note also that the measure does not contain any increase in the ability to start additional pensions with the contributed amounts due to downsizing. The amount of funds transferred into pension phase is still limited to the person's transfer balance cap, set at \$1.6 million for 2017-18 financial year.

Case study to explain the measure

George and Jane, both retired and aged 76 and 69, sell their home to move into more appropriate accommodation. The sale proceeds are \$1.2 million. They can both make a non-concessional contribution into superannuation of \$300,000 (\$600,000 in total), even though Jane no longer satisfies the standard contribution work test and George is over 75. They can make these special contributions regardless of how much they already have in their accounts.

Note in this example that George's and Jane's entitlement to Age Pension will be reassessed as their assets have increased by \$600,000.

LRBAs and non-arm's length income arrangements

The outstanding balance of a limited recourse borrowing arrangement (LRBA) will now be included in a superannuation fund member's annual total superannuation balance. The repayment of the principal and interest of an LRBA sourced from funds used to support the member's accumulation account will result in a transfer balance credit in the member's transfer balance account in cases where such repayment increases the value of the pension account.

Another measure is aimed at improving the non-arm's length income (NALI) provisions. In deciding whether the transaction is entered into on a commercial basis, the costs that would normally apply to a commercial transaction would be included in consideration. Consequently, superannuation funds that avoid costs through non-arm's length dealings will be subject to NALI rules. Any income that is found to be NALI is taxed at 47%.

The new LRBA rules will commence from 2017-18, and the changes to the NALI rules are to take effect from 2018-19.

The measure, aimed at improving the integrity of LRBAs, is a result of government's concern that LRBAs can be used to circumvent contribution caps and effectively transfer growth in assets from the accumulation phase to the retirement phase that is not captured by the transfer balance cap.

The strengthening of NALI rules appears to be aimed at non-arm's length transactions that result in a superannuation fund incurring significantly lower transaction costs compared to arrangements entered on a genuine commercial basis. Current NALI rules focus primarily on the amount of income derived from the non-arm's length scheme. ■