

# Beyond Numbers **May 2019**

## Inside

### **1 WHAT YOU CAN EXPECT AFTER THE ELECTION**

#### **2 BUDGET 2019-20: THE PRE-ELECTION ANNOUNCEMENTS THAT ARE NOW LAW**

- 2 Extension and increase to the instant asset write-off
- 3 One-off energy assistance payments
- 3 Medicare levy and surcharge income threshold increase
- 3 North QLD flood recovery

#### **3 ATO DOUBLES RENTAL DEDUCTION AUDITS**

#### **4 A LABOR GOVERNMENT ON TAX & SUPER**

- 4 Tax on investment property
- 4 Dividend imputation and the impact on self-funded retirees
- 6 Minimum 30% tax on discretionary trust distributions
- 6 Capping deductions for managing tax affairs
- 6 Tightening of superannuation framework

# What you can expect after the election

**Headlines only explain so much. In this special update, we examine where the 2019-20 Federal Budget left us, and the pivotal policies from the ALP on tax, superannuation and business.**

There are no guarantees, however, that any policies or announcements not already legislated will come to fruition – that will depend on the Senate composition. At the next election, 40 of the 76 Senate seats will be contested - 6 in each State and 2 in the Territories. The final Senate composition will determine what policies become a reality, the more controversial the policy the less likely it is to pass the Senate. Let's take a look!

# Budget 2019-20: The pre-election announcements that are now law

The Federal Budget announced a series of measures, some of which were legislated before the election was called.



## Extension and increase to the instant asset write-off

The popular instant asset write-off for small business has been extended and increased. The new laws:

- increase the threshold below which small business entities can access an immediate deduction for depreciating assets and certain related expenditure (instant asset write-off) from \$25,000 to \$30,000; and
- enables businesses with aggregated turnover of \$10 million or more but less than \$50 million to access instant asset write-off for depreciating assets and certain related expenditure costing less than \$30,000.

Assets will need to be used or installed ready for use from Budget night until by 30 June 2020 to qualify for the higher threshold. Anything previously purchased does not qualify for the higher rate but may qualify for the \$20,000 or \$25,000 threshold. Similarly, anything purchased but not installed ready for use by 30 June 2020 will not qualify.

The instant asset write-off only applies to certain depreciable assets. There are some assets, like horticultural plants, capital works (building construction costs etc.), assets leased to another party on a depreciating asset lease, etc., that don't qualify.

## For assets costing \$30,000 or more

For small businesses (aggregated turnover under \$10m), assets costing \$30,000 or more can be allocated to a pool and depreciated at a rate of 15% in the first year and 30% for each year thereafter. If the closing balance of the pool, adjusted for current year depreciation deductions (i.e., these are added back), is less than \$30,000 at the end of the income year, then the remaining pool balance can be written off as well.

The 'lock out' laws for the simplified depreciation rules (these prevent small businesses from re-entering the simplified depreciation regime for five years if they opt-out) will continue to be suspended until 30 June 2020.

Pooling is not available for medium sized businesses which means that the normal depreciation rules based on the effective life of the asset will apply to assets that don't qualify for an immediate deduction.

*Continued over the page...*

The amendments apply from 7.30 pm legal time in the Australian Capital Territory on 2 April 2019 until 30 June 2020

### **One-off energy assistance payments**

A one-off energy assistance payment of \$75 for singles and \$62.50 for each eligible member of a couple, will be made to predominantly pension and social welfare recipients who were residing in Australia on 2 April 2019. The payments are expected to be completed by 30 June 2019.

### **Medicare levy and surcharge income threshold increase**

The Medicare levy low income thresholds for singles, families, and seniors and pensioners will increase from the 2018-19

income year, meaning more people will be excluded from paying the levy.

### **North QLD flood recovery**

Grants are treated as non-assessable non-exempt income if they:

- are Category C or D measure disaster recovery grants paid to small businesses, primary producers or non-profit organisations; and
- relate to flooding that commenced in Australia in the period between 25 January 2019 and 28 February 2019 (inclusive).

As a result, Category C and D measure grants to small businesses, primary producers and non-profit organisations affected by floods in North Queensland in late January 2019 and that continued into February 2019 are non-

assessable non-exempt income.

And, grants to primary producers are non-assessable non-exempt income if the grants are for repairing or replacing farm infrastructure, restocking or replanting, and they are provided for the purposes of an agreement between the Commonwealth and a State or Territory to assist primary producers affected by the flooding.

As a result, such grants to primary producers in North Queensland affected by floods in late January 2019 that continued into February 2019 are non-assessable non-exempt income.

## **ATO doubles rental deduction audits**

**In the 2017-18 financial year, more than 2.2 million Australians claimed over \$47 billion in deductions and the Australian Taxation Office (ATO) thinks that is too much - one in ten is estimated to contain errors.**

4,500 audits of rental property deductions will be undertaken this year with the focus on over-claimed interest, capital works claimed as repairs, incorrect apportionment of expenses for holiday homes let out to others, and omitted income from

accommodation sharing. Deliberate cases of over-claiming are treated harshly with penalties of up to 75% of the claim. In one case exposed by the ATO, a taxpayer had to pay back \$12,000 in claims for deductions against a holiday home that was not

genuinely available for rent and was blocked out during the holiday season. In another, a taxpayer paid back \$5,500 because they had not apportioned their rental interest deduction to account for redraws on their investment loan to pay for living expenses.

# A Labor Government on Tax & Super

## Tax on investment property

In general, taxpayers are able to deduct from their assessable income any expenses they incur generating or producing that income. An investment is negatively geared when the cost of owning the asset is more than the return. Negative gearing is not limited to property but can apply to other assets such as shares. In 2016-17, Australians claimed \$47.5 billion in rental deductions against gross rental income of around \$44.1 billion.

A number of capital gains tax (CGT) exemptions potentially apply to investment property. For Australian resident individuals, a 50% CGT discount applies to net capital gains made on investments held for longer than 12 months. In addition, a taxpayer's main residence is exempt from CGT. As part of this exemption, a taxpayer can be absent from their main residence for up to 6 years and still claim the property as their main residence (assuming they do not treat any other property as their main residence). So, the property can be used as an investment property for 6

years but then sold as the taxpayer's main residence.

Labor's plan seeks to:

- **Limit negative gearing to new housing from 1 January 2020.** All investments made prior to this date will not be affected by the changes and will be fully grandfathered. The ALP states that the grandfathering element of the policy applies to property and assets purchased prior to the start date of the policy. "This means, for example, that if you own a property prior to 1 January 2020, you are able to negatively gear it after that date."
- **Halve the capital gains tax discount for all assets purchased after 1 January 2020.** This will reduce the CGT discount for assets held longer than 12 months from 50% to 25%. Once again, all investments made prior to the 1 January 2020 will be fully grandfathered. The changes will not apply to superannuation funds or to the 50% active asset reduction concession that applies to small businesses.

There is no policy statement from the ALP on the main residence exemption. The Morrison Government had introduced legislation to remove access to the main

residence CGT exemption for non-resident taxpayers, but this Bill stalled in the Senate. Chris Bowen told the *Australian Financial Review* that it will be up to the ALP to work through outstanding tax measures and "iron out any unintended consequences" including the impact on expats and retrospectivity.

## Dividend imputation and the impact on self-funded retirees

One of the more controversial measures announced by the ALP is the reform of the dividend imputation credit system to remove refundable franking credits from shares. The measure, as announced, would apply to individuals and superannuation funds, and exclude Australian Government pension and allowance recipients, and tax-exempt bodies such as charities and universities. SMSFs with at least one pensioner or allowance recipient before 28 March 2018 will also be exempt from the changes. The policy is intended to apply from 1 July 2019.

*Continued page 5...*

## How does the system currently work?

A dividend is a shareholder's share of a company's earnings (profits). When a dividend is paid from an Australian company's after-tax profits, these are known as franked dividends and include a franking credit (imputation credit), which represents the amount of tax already paid by the company on the underlying profits that are being paid out in the form of a dividend.

An Australian resident shareholder pays tax on dividends they receive (as dividends are treated as income). If the dividend received is a franked dividend, the shareholder includes the franking credits in their income (i.e., a gross-up occurs) but they can then use the franking credit attached to the dividend to reduce their tax liability. If the credit exceeds their tax liability for the year then they receive a cash refund for the excess amount. For example, an SMSF owns shares in a company. The company pays the SMSF a fully franked dividend of \$7,000. The dividend statement says there is a franking credit of \$3,000. The \$3,000 represents the tax the company has already paid on its profits. This means the profit, before company tax was subtracted, would have been \$10,000 (\$7,000 + \$3,000). The SMSF must declare \$10,000 worth of

income and will receive the \$3,000 as an offset.

## The sensitivity of the issue

The sensitivity of this issue is how the dividend imputation system interacts with the way superannuation is taxed. Currently, income an SMSF earns from assets held to support retirement phase income streams (i.e., a pension), such as dividends from shares, is tax-free. That is, a self-funded retiree in some circumstances pays no tax on the income they earn from dividends. If they pay no tax, then any franking credits are paid as a cash refund.

If the ALP policy comes to fruition, these self-funded retirees lose this cash payment unless they are also Australian Government pension and allowance recipients.

## Who will be impacted by the change?

Based on information from Treasury, 85% of the value of franking credit refunds go to individuals with a taxable income below \$87,000. That is, 97% of taxpayers receiving refunds have a taxable income below \$87,000. And, more than half of those receiving a franking credit refund have a taxable income below the tax-free threshold of \$18,200. Around 40% of SMSFs receive a franking credit refund.

Around 1.1 million individuals received a franking credit refund in 2014-15 with more than half of these over the age of 65. And, more than two thirds of refunds to SMSFs are to those whose fund balance per member is greater than \$1 million. However, this figure is likely to be diminished by the 1 July 2017 reforms that imposed a \$1.6m cap on retirement phase superannuation accounts and tax earnings on accumulation accounts.

The Parliamentary Budget Office has also outlined what behavioural changes they expect to see in the market as a result of making franking credits non-refundable. These include shifting from shares to alternative investment arrangements, and couples shifting ownership of shares from the lower income earner to the higher income earner to utilise the franking credits as a non-refundable tax offset.

The most significant behavioural change is expected to be from SMSF trustees: *"The assumed behavioural response for SMSFs in 2019-20 is equivalent to these funds, in aggregate, moving around a quarter of the value of their listed Australian shares into APRA-regulated funds that are in a net tax-paying position."*

The alternative, of course, is for SMSFs to change their composition of Australian shares to reduce their holding.

The Parliamentary Budget Office also notes that one potential outcome is that SMSFs will increase the number of taxpaying members. *“For instance, a couple with an SMSF in the pension phase could invite two additional working-aged children into their fund, allowing them to use their excess franking credits to offset the contributions and earnings tax payable on the assets owned by their children.”*

### **Minimum 30% tax on discretionary trust distributions**

There are around more than 690,500 discretionary trusts, also known as family trusts, in Australia. Discretionary trusts are popular as the trustee has the discretion on how to pay the income or capital of the trust to the beneficiaries – beneficiaries do not have an interest in the trust. Income can be apportioned by the trust to the beneficiaries on a discretionary basis, for example, to beneficiaries on a lower income tax bracket. As a result, discretionary trusts are often used to protect assets within family groups, manage succession, and to distribute income tax effectively within that group.

From 1 July 1979, laws were introduced to ensure that distributions to minors were taxed at the top marginal tax

rate to prevent trusts distributing funds to children at minimum tax rates.

### **The proposed reforms**

The ALP reforms address the ability for distributions to be channelled to beneficiaries in low income tax brackets. Instead, a new standard minimum rate of tax for discretionary trust distributions to mature beneficiaries (aged over 18) of 30% will apply.

### **Tightening of superannuation framework**

Mr Shorten told a media conference in April that the ALP had “no plans to increase taxes on superannuation.” ALP policy however does recommend changes in a series of areas. These include:

- **Non-concessional contributions** – the non-concessional contributions cap (the amount you can contribute to super from your after-tax income), will be reduced to \$75,000 from 100,000.
- **Division 293 tax** - High income earners pay an additional 15% tax on their concessional taxed contributions to superannuation. Currently, the threshold at which this tax applies is \$250,000. The ALP intends to reduce this threshold to \$200,000.

- **Remove the ability to ‘catch up’ superannuation concessional contributions** – Individuals with a total superannuation balance of less than \$500,000 just before the start of the financial year are top up their concessional contributions in that financial year by using their unused concessional contribution cap amounts carried forward from the previous five years. This measure can only be applied to unused cap amounts from the 2018-19 year. The ALP intends to remove the ability to use unused cap amounts.
- **Remove measures expanding tax deductibility for super contributions** - Under the super reform measures, the ‘substantially self-employed test’ (‘10% test’) was removed. This enabled taxpayers, regardless of their work status (but otherwise eligible to contribute) to claim a tax deduction on their personal super contributions. The ALP intends to unwind these reforms.

### **Capping deductions for managing tax affairs**

The ALP intends to cap the tax deduction available for the cost of managing tax affairs to \$3,000. While clients can spend more than this, the portion above \$3,000 will not be tax deductible.