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Tax Insights

"Careful but bold" Labor tax policies

Snapshot

On 5 March 2018, Shadow Treasurer Chris Bowen set out Labor's philosophy on tax reform and Budget repair. As part of the speech, Mr Bowen stated Labor was prepared to lead the tax policy debate and tackle the big issues, to be "careful but bold".

Labor has since announced two major tax initiatives in addition to its previously announced tax policies;

- The removal of imputation credit refunds
- The introduction of an Australian Investment Guarantee (a form of accelerated depreciation).

Removal of imputation credit refunds

Under a Labor government, from 1 July 2019, imputation credits for individuals and superannuation funds would no longer be a refundable tax offset. This means that imputation credits can be used to reduce tax payments, but that taxpayers cannot obtain cash refunds for excess imputation credits.

This measure is estimated to save the Budget $11.4 billion over the four year forward estimates period, and $59 billion over the decade to 2028-29.

Labor policy proposal as so far outlined will only apply to individuals and superannuation funds. Income tax exempt charities and not-for-profit institutions with deductible gift recipient status will continue to receive refunds. Labor policy is silent on it's application to companies who are able to convert unused imputation credits to tax losses[1].

The policy has been justified on the basis of the cost to the Budget (the measure is described as "simply unaffordable") and Labor's distributional analysis of who benefits from the current refunds.

As we have seen before on other tax debates – negative gearing, CGT discount, costs of managing tax affairs, amongst others – there are always (at least) two sides to the political narrative around a tax policy proposal. This has indeed been the case in the period since Labor's announcement with claim and counter-claim as to who benefits from the current arrangement and who will be affected by the proposal.

The irony in this debate, is that higher wealth taxpayers and self-managed superannuation funds may have a number of options to restructure their affairs. For instance, wealthier individuals and SMSF funds may decide to reweight their investment strategy, move funds in or out of superannuation, pay or cease paying dividends from family owned companies and/or change the segregated nature of their superannuation fund (these decisions however, raise a host of other tax and non-tax issues to consider as a consequence).

Public sector superannuation schemes who tend to have more significant pension member percentages, eligible roll-over funds and segregated retail products will all have challenges to understand what modelling may need to be done on the impact of their future forecasted cash flows and the restructuring options available to them to reduce the impact of the policy on returns to members.

The policy also creates additional change in the superannuation industry which was assured by both parties in the past year that superannuation tax policy would be stable for the short to medium term. The Government's *Superannuation (Objective) Bill 2016* which was to establish the primary objective of the superannuation system, and also require the preparation of a 'statement of compatibility' for future Bills relating to changes in superannuation, has been held up in the Senate since November 2016.

"Part of the problem with the Budget of course is that … the Howard-Costello Government, locked in a lot of unsustainable spending and also tax concessions when the Budget was being hit with gold bars during the mining boom. The mining boom was always going to end one day, it's one of the golden rules of economics. But the Howard Government locked in new permanent initiatives funded by the temporary boost to government revenue from the commodities boom"

Chris Bowen, Shadow Treasurer, 5 March 2018

[1] Section 36-55 Income Tax Assessment Act 1997

In the period since the announcement, there has been some speculation that the measure may be modified for pensioners (such as allowing a cap of $500 or $1,000 of refund), however Labor has not specifically outlined any ameliorating measures, with Bill Shorten simply stating: "In terms of pensioners, I give this promise too: pensioners will always be better off under a Labor Government. We're always working on ways to make sure that the least well off and our older Australians, get the best deal possible, and so we'll have more to say about that in coming weeks."[2]

Australian Investment Guarantee

As an alternative to a lower company tax rate, Labor has proposed an Australian Investment Guarantee applying from 1 July 2020.

This is a form of accelerated depreciation, which would allow businesses to immediately expense 20 per cent of the value of eligible depreciable assets in the first year of all new investments, with the balance depreciated in line with normal depreciation schedules from the first year.

The measure bears some resemblance to the recently announced US tax reform of immediate expensing capital investment. The US law is more far-reaching as it will allow a 100% write off in the year of acquisition (scaling down to less than a 100% write off after 2023).

The Australian Investment Guarantee is to be a "permanent measure", that is, it would not terminate after a number of years. (The current Federal Government $20,000 instant asset write-off is due to cease at 30 June 2018).

Eligible assets criteria:

- Eligible investments valued at over $20,000 (with no pooling of assets allowed) can access the guarantee, and include:
    - Tangible machinery, plant and equipment for both upgrades and new purchases, including non-passenger motor vehicles such as lorries, vans, utes and trucks that are used to support trade businesses
    - Depreciable intangible assets (often referred to as "knowledge assets") which make up an increasingly larger component of non-mining investment will also be eligible: for example, new investments in computerised technology (such as new software) and intellectual property such as patents and copyrights.

- The following would be excluded
    - Investments in structures and buildings, consistent with previous accelerated depreciation policies used in Australia
    - Otherwise eligible expenditure currently claimed under the existing research and development tax concession
    - Passenger motor vehicles.

"An important part of any sensible fiscal strategy is identifying those tax concessions which eat away at the revenue base and reform them or abolish them in order to underpin both Budget repair and the funding of new initiatives"

Chris Bowen, Shadow Treasurer, 5 March 2018

[2] Doorstop interview Gladstone, 21 March 2018

Example
Manufacturing Company A purchases a new $10 million piece of machinery Under normal depreciation rules for this piece of machinery (assuming a straight line depreciation method) Manufacturing Company A is allowed to deduct 10 per cent or $1 million of the $10 million in each year over the effective 10 year life of the asset. Under Labor's Australian Investment Guarantee, Manufacturing Company A will be able to immediately expense 20% ($2 million) of its investment in the first year. The remaining 80% ($8 million) would then be depreciated over the effective life of the asset from the first year in line with the original depreciation schedule – which in this case is 10 per cent per year, or $800,000 of the $8 million. This means Manufacturing Company A can write off a total of $2.8 million in the first year ($2 million plus $800,000) of its investment (instead of $1 million under existing arrangements).

Labor has long opposed the Federal Government's proposed reduction to the company tax rate on the basis of cost to the Budget and the uncertainty of the impact of such cuts on the economy. This policy is designed to satisfy both of these concerns by being less costly ($3.3 billion over the 4 year forward estimates), and by being a more targeted incentive for new investment in capital assets.

Other ALP tax policy announcements

Labor has also announced the following tax policies which it will take to the next election:

Previously announced measures primarily impacting individuals and trusts

Labor supports the 0.5 per cent increase in the Medicare Levy but only for those earning over $87,000. It would also reinstate the Budget deficit Repair levy of 2% for those taxpayers with taxable income in excess of $180,000.

Labor proposes to apply a minimum tax rate of 30% on discretionary trust distributions to adult beneficiaries beginning on 1 July 2019. Currently, such distributions are subject to tax in the hands of beneficiaries at marginal income tax rates, which could result in low effective tax rates for those distributions.

Labor proposes that negative gearing would be retained in its current form only for new housing and existing assets. Negative gearing losses in respect of all other assets will be limited to being deductible against other investment income or capital gains (but not against wages and salaries).

The CGT discount would be reduced for individuals (not super funds or small business assets) to 25% with existing assets to be fully grandfathered.

Labor would seek to cap the amount individuals can deduct for the management of their tax affairs at $3,000 from 1 July 2019. This cap would affect individuals, trusts and partnerships. A carve-out would be provided for individual small businesses with positive business income and annual turnover up to $2 million.

Previously announced measures impacting corporates and multinationals

With regard to the Labor position on corporate tax rate cuts already passed, Bill Shorten has confirmed that Labor would support corporate tax rate cuts only in respect of businesses with turnovers under $2 million. If this policy position was maintained, we would see some companies being subject to a tax rate increase from 27.5 per cent back to 30 per cent.

The previously announced ALP multinational tax package includes the following elements:

- *Debt deductions*

  Eliminate the safe harbour and the arm’s length debt test in the thin capitalisation rules and have a single test limiting debt deductions: the world wide gearing ratio. This means that the amount of permissible debt would be limited to the debt to equity ratio of the entire global group.

- *CbC public reporting*

  Labor supports the public disclosure of country-by-country (CbC) reports that will be lodged by significant global entities (SGEs).

- *Mandatory shareholder reporting of tax haven exposure*

  Labor proposes changes to the *Corporations Act 2001* such that companies would be required to disclose to shareholders dealings in any ‘international material tax risk jurisdiction’ (i.e. known or suspected tax havens).

- *Other*

  Transparency: The ATO annually publishes tax-paid data for many companies. Labor proposes to reduce the threshold for tax transparency reporting for private companies to $100 million; a measure estimated to affect approximately 600 large private companies with turnover of between $100-200 million. An ALP Bill to this effect is currently sitting in the Senate.

  Community input: Ensuring community sector representation on the Board of Taxation to balance feedback.

  Whistle blower laws: Greater whistle-blowers protections are currently being legislated. Labor also proposes to provide rewards for whistle-blowers who report entities evading tax to the ATO.

Public reporting of AUSTRAC data: Labor would require the annual public release of international funds transfer data, being the aggregate total of funds transferred from Australia to individual overseas destinations.

Government contracts: In line with recommendations from the Senate Inquiry into corporate tax avoidance, all firms tendering for Australian Government contracts worth more than $200,000 would be required to state their country of domicile for tax purposes.

Tax haven investment by superannuation funds: Labor proposes that the ATO (in collaboration with the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority) develop guidelines for responsible investment by superannuation funds. This is intended to ensure that funds are transparent about their dealings in such jurisdictions.

Beneficial ownership: Treasury work is currently underway on the details, scope and implementation of a beneficial ownership register for companies. Labor has reiterated its election policy for a publicly accessible central registry of the beneficial ownership of companies, trusts and other corporate structures to be established.

ATO disclosure of settlements and reporting of aggressive tax minimisation: Finally, Labor would require that the ATO's annual report provide information on the number and size of tax settlements above a value of $50 million, estimated to be approximately 8 settlements per annum.

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