Tax Insights

The Government's tax agenda: gliding or crashing?

Snapshot

Surely a man cannot jump out of a plane with no parachute from 25,000 feet above the earth and glide safely to earth? As we know, it can and has been done. Luke Aikins guided himself over 7 kilometres towards an impossibly small net – and landed safely. If that is possible, is it also possible to develop tax policy that is in the national interest and that assists in guiding a transitioning economy through challenging times? We are about to find out!

The tax system has undergone significant change in the last few years, domestically and internationally. However, a comprehensive approach to getting tax policy settings right is still vital and requires much further work.

Where can we expect that the 45th Parliament will take tax policy in Australia? Comprehensive tax reform proved elusive in the last Parliament. Prior to the election the Government proposed a 10 year "glide path" to implement a corporate tax rate cut as well as personal tax cuts, superannuation reforms and other business tax changes. The question is whether the Government's tax policy agenda will glide, albeit with some turbulence, to a final landing or whether the tax policy reforms proposed in this year's Budget will crash.

Election 2016: A near death political experience

The Coalition has been returned to Government with the smallest of margins, one seat. Given that the Coalition campaigned strongly on "jobs & growth" and corporate tax cuts, the election outcome is not a ringing endorsement.

Watching the drawn out events on the night of the election, observing the slow vote count in some key seats and pondering the makeup of the new Senate has already been draining: and this is all before the new Parliament has even sat for the first time.

The cross bench in the House of Representatives will include the following non-mainstream members:

- Rebekha Sharkie (Nick Xenophon Team (NXT))
- Cathy McGowan (Independent)
- Andrew Wilkie (Independent)
- Bob Katter (Katter's Australian Party)
- Adam Bandt (Greens).

Aside from Rebekha Sharkie, the key positions of all of these members are well known to the Government.

Given the small majority, the need for the Government to appoint a Speaker, the Senate significance of the Greens and NXT and the chaos that can happen in politics, the influence of the cross benchers in the House of Representatives whilst marginal, should not be discounted.

In the Senate, the Government will not have a majority in the new term, and will have to negotiate with either the Greens or a large and disparate group of crossbenchers. The final composition of the 76 members of the Senate will be:

Coalition	30	Greens	9	NXT	3
ALP	26	One Nation	4	Other	4

In relation to tax matters, key returning Senators are Peter Whish-Wilson (Greens) and Nick Xenophon, both of whom were members of the Senate Inquiry into corporate tax avoidance. Richard Di Natale will also be pivotal in the next term as leader of the Greens.

A Senate majority requires 39 votes. On matters where the ALP opposes the Government's proposals, the Government will require the support of the Greens or at least 9 of the 11 other cross bench Senators to progress legislation through Parliament.

The headline tax issues leading into the new Parliament are personal tax cuts, company tax rate cuts, anti-avoidance tax measures, small business tax measures and superannuation.

The passage of the multinational anti-avoidance law (MAAL) in December 2015 is an example of tax and messy politics. The MAAL, which had unanimous support, became hostage to a debate about the preferred transparency measures. It serves as a reminder that the politics of tax can be unpredictable, especially in an environment where multinational tax remains a hot button issue and all sides want to be strong on this issue. **Expect to see some surprises in the new Parliament as tax and politics mix.**

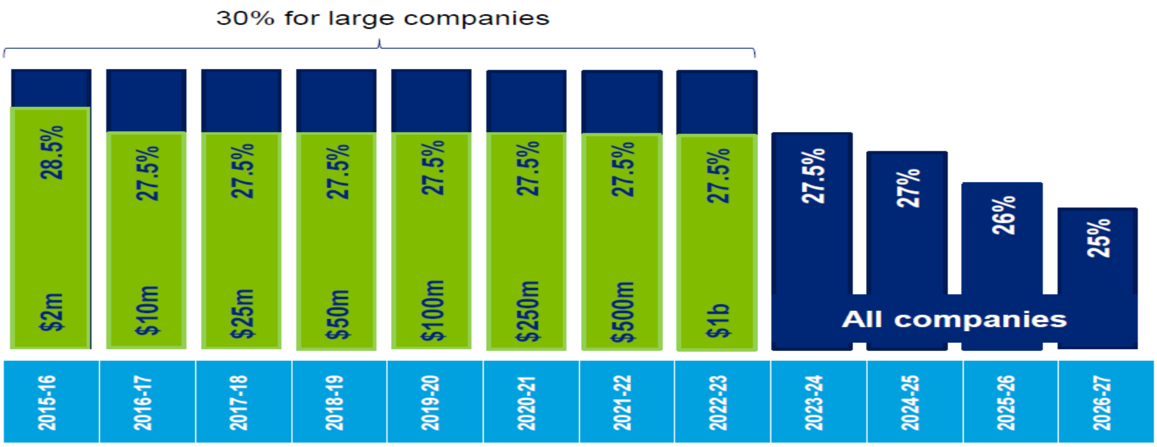
Tax cut for individuals: first off the blocks

The tax cut for individuals is the most pressing from a time and political perspective. Due to commence on 1 July 2016, it is expected that this legislation will be given priority. Who will stand in the way of a personal tax cut for middle Australia?

The measure is likely to proceed given ALP support, but the issue is likely to become tied to some robust debate around matters such as the extension of the 2% temporary budget repair levy, an increase in the Medicare levy, higher rates for incomes over $1M, the so-called Buffet Tax on high gross incomes and a limitation on the deductions available to individuals for managing tax affairs: all of these related issues have been floated by one or other of the key players.

Company tax: gliding or crashing?

The Government has advised that all Budget legislation will be presented by the end of the year, but has given contradictory messages on whether the 10 year glide path will be presented as a single legislative package.



In the Upper House, the Greens, NXT and the ALP are opposed to a broad ranging tax cut. The announced positions of these parties are as follows:

Party Positions	Detail
ALP	Support tax cut for "small business" to 27.5% and ultimately 25% - under $2m turnover
Nick Xenophon Team	Support tax cut for "small business" to 27.5% - under $10m turnover
Greens	Don't advocate tax cuts for business. But support change in definition of small business to under $10m turnover.

What might the political argument focus on? As we saw in the election campaign, there are many contrary views presented, and the Government struggled to cut through with its narrative of convincing a sceptical public of the benefits of a company tax rate cut. Based on what we have already seen, we can expect much debate about the following matters.

Debt & deficit versus jobs & growth: The cross benchers need to be convinced that a company tax rate cut will result in "jobs and growth" by providing a stimulus to the economy that would partly offset tax collections forgone in the short term (with an increasing collection over time from increased investment). Despite Treasury analysis supporting this, there are many different views.

Equity and conduct: Public perceptions around corporate conduct and multinational tax avoidance leave little space for public support for a company tax rate cut.

Who benefits?: Despite Treasury analysis, there are competing views as to who benefits from a company tax rate cut and to what extent: employees, Australian shareholders (including superannuation funds), foreign shareholders and foreign governments.

It will be a test of the Government's negotiating and communication skills to get the corporate tax rate cut "glide path" proposal off the ground. **The political reality is that this long term package of company tax cuts is likely to be negotiated down**, and that unless there is some significant policy compromise, we venture that legislation will be passed that allows, for example, only companies with turnover of up to $10 million to benefit from a tax rate reduction.

Anti-avoidance provisions: continued momentum

Anti-avoidance measures, especially relating to multinational tax and the OECD Base Erosion and Profit Shifting (BEPS) Action Plan, were the focus of several pre-election Budget announcements:

- A new Diverted Profits Tax (DPT)
- Anti-hybrid changes
- Adoption of new OECD transfer pricing guidelines
- A new regime requiring tax and financial advisors to report potentially aggressive tax planning schemes
- Increased penalties for non-lodgement of tax documents for significant global entities
- New protection for tax whistleblowers
- A new tax avoidance taskforce

The thrust of these measures is to address integrity concerns about the tax base and all-party support is expected in principle, albeit differences may emerge in the detail. Most critical from a timing perspective is the development of the DPT and anti-hybrid legislation. Both measures are complex and important – adequate time is required for effective consultation and legislative development. The Government should target the end of this year for passage of the DPT legislation and early 2017 for passing the anti-hybrid legislation.

The ALP continues to support an overhaul of the rules for interest deductions – their proposal replaces the existing asset based thin capitalisation rules and does not follow the OECD EBITDA approach, but instead caps interest deductions by reference to the actual worldwide gearing levels of the relevant group. The Greens also support such a measure.

We are still awaiting the reforming of Senate Committees, including the Inquiry into corporate tax avoidance, but we expect that this Inquiry will be reformed in 2016, and likely beyond.

Tax transparency will remain a focus, and further calls for new and increased transparency measures are likely to emerge in the political debate. This will manifest itself in various guises: the Coalition has stated it is considering options for a beneficial ownership register based on recommendations in the OECD BEPS Action plan and this would get support from both the ALP and the Greens.

The exact form of the tax paid data published by the ATO may be revisited (e.g., the relevant turnover thresholds and the data disclosed). The reporting threshold for Australian-owned resident private companies of total income of $200 million or more negotiated with the Greens last year may change as the Greens now want disclosure to be at a lower threshold of $50M. There is no doubt that more media and public attention will be focused on this issue in the coming year.

There will also be much focus on the take-up of the Voluntary Tax Transparency Code. We have already seen companies taking the lead on that measure and setting out to meet, or exceed, public expectations. For companies debating whether to adopt the code, we consider that the position is clear: the public expectations of the tax environment have changed forever, and the sooner that companies adjust to the new normal, the better.

Small business tax measures will fly

The Government has proposed an increase to the small business turnover threshold from $2 million to $10 million from 1 July 2016, allowing more small businesses to access many of the small business tax concessions (including the instant asset write-off).

It has been reported that the NXT supports lifting the limit on the small business tax breaks to $10 million and has indicated that providing extended access to the immediate write-off of assets worth up to $20,000 was more important that a cut in the company tax rate.

The Greens also support an increase the small business entity turnover threshold to an annual turnover of no more than $10 million per annum. As such, we would expect that the increase to the turnover threshold for small business to $10 million will proceed as announced.

Other business tax changes: all in good time

The 2016-17 Federal Budget also contained a number of business tax changes such as:

- The creation of new forms of Australian collective investment vehicles (CIV) for investors to pool their funds with Australian fund managers
- Tax consolidation amendments in respect of deductible liabilities, deferred tax liabilities and securitised assets which broadly address integrity concerns
- Reforming the taxation of financial arrangements (TOFA) regime by implementing simplified rules
- Targeted amendments to simplify Division 7A (transfers from private companies) and
- Removal of key barriers to use asset backed financing (relevant to Islamic financing).

These measures are all positive changes for the Australian economy and the Australian taxation system and are likely to have bi-partisan support. The challenge will be to get the legislation through the consultation and drafting phases and onto the Parliamentary calendar. The first round of the CIV changes is due to commence from 1 July 2017 and so are time-critical.

It is expected that easing restrictions on Islamic finance will open up access to Middle Eastern sovereign wealth funds for investment in Australian projects. The One Nation party has announced that it will not support these changes.

Superannuation: a political hot-potato

It is far from clear as to where the superannuation reforms will land. This is a key area to get the settings right: to address concerns of fairness and equity, to provide the right incentives to achieve policy objectives and to do so in a way that is as simple as possible from an administrative perspective.

The purpose of superannuation

Can we at least agree on this? The Government has announced that the objective for superannuation is "to provide income in retirement to substitute or supplement the Age Pension." This objective is important as all new superannuation legislation will be considered in the context of the objective. The Shadow Treasurer Chris Bowen has recently indicated that this objective **is not one that has bi-partisan support**, so even the starting point will have to be negotiated.

It is likely that this objective will not significantly change after negotiation, but it will likely provide yet another political battleground.

Superannuation controversy - the sustainability provisions

There are 2 measures that have triggered the most angst in the electorate:

- The $1.6 million pension transfer cap, and
- The $500,000 lifetime cap on non-concessional contributions.

The Treasurer has acknowledged that there are some technical issues that need to be resolved, which will be dealt with during consultation.

The Government is **standing firm on all their superannuation measures** with Scott Morrison stating that: *"We took this policy to the election; we put it in the Budget. It sits critically as part of our fiscal strategy as well as our strategy to make sure we're addressing the ageing of our population and the sustainability of our superannuation system". [Interview with Jon Faine, ABC 774 on 27 July 2016]*

Retrospectivity

Whether the changes are **retrospective**, or whether there should be **grandfathering** (that is current balances should be protected from law change) has been a much debated topic.

Prior to the election, the ALP indicated that it will wait until the 2017 Federal Budget to decide whether it will adopt the Coalition's proposed cuts to superannuation concessions and that Treasury's review and consultations would determine whether there was a better way to do things and **whether the controversial measures were really retrospective.** The ALP has now confirmed that it considers the changes to the $500,000 lifetime contribution cap to be retrospective and will not support the backdating of this measure to 2007.

Timeline

The Government has confirmed that it expects to begin consultation on exposure draft legislation shortly and will listen carefully to advice on the design of the legislation.

The good measures - what we didn't hear about during the election

Despite the Government making 10 significant budget announcements in respect of superannuation, most of the media and political discourse was focused on just two measures (the $1.6 million pension transfer cap and the $500,000 life-time cap on non-concessional contributions). That the other measures were not a focus of the election campaign is a disappointment for the Government trying to communicate its superannuation reform agenda.

The bulk of the superannuation measures actually benefit the majority of taxpayers by adding flexibility to the superannuation system. The announcements set out below are aimed to assist people who are self-employed, don't have salary sacrifice arrangements in their jobs, leave the work for illness or parenting duties or work part time and are a significant shift from previous rules. These measures are beneficial for the superannuation system but will not all receive bi-partisan support with the ALP advising in August that it will not support the removal of the work test, top up contributions and rolling catch-up contributions due to their cost to the budget.

Issue	Detail	Due to be effective
Flexibility		
Work test removed	For individuals aged from 65 to 74 years of age to make superannuation contributions	1 July 2017
Top up contributions	Contributions are now deductible for personal superannuation contributions up to the cap	1 July 2017
Eligibility for the low income spouse superannuation tax offset	Provides an offset to $540 for contributions made for contributing spouse whose income is less than $37,000	1 July 2017
Rolling catch-up contributions	Applies where balances are less than $500,000, allowing unused cap amounts to be carried forward on a rolling basis for 5 consecutive years	1 July 2017
Pension products	The tax exemption for earnings on assets supporting income streams to include deferred annuities and group self-annuitisation products	1 July 2017

Integrity provisions

Some of the concessions in respect of anti-detriment payments and Transition-to-Retirement pensions have been wound back. These did not get much attention during the election campaign.

The ALP is expected to support this measure.

Issue	Detail	Due to be effective
Integrity		
Anti-detriment provision for death benefits	Will be abolished	1 July 2017
Transition to retirement income stream (TRIS) changes	Earnings on assets supporting TRISs will be taxable, no lump sum capability	1 July 2017

The sustainability provisions

The sustainability provisions are split between measures winding back concessions and those encouraging superannuation contributions.

Issue	Detail	Due to be effective
Sustainability		
Pension transfer cap	New maximum balance of $1.6 million	1 July 2017
30% tax on concessional contributions	Threshold was $300,000 income, now reduced to $250,000	1 July 2017
Annual cap on concessional contributions	To be reduced to $25,000 per annum	1 July 2017
Lifetime cap on non-concessional contributions	Annual caps removed. Lifetime cap introduced of $500,000	Effective immediately
Low income superannuation tax offset	Similar to current LISC	1 July 2017

Our predicted outcomes on these measures are:

Pension transfer cap: The pension transfer cap is aimed at ensuring that superannuation is not used as an estate planning tool. The ALP policy is broadly similar in concept but taxes on an earnings basis rather than an asset basis. Given the similarity of the two policies it is possible that this budget measure will have bi-partisan support.

30% tax on contributions & low income superannuation tax offset: These measures were expected to have bi-partisan support, given the similarities between the ALP and Coalition policies, however the ALP has just announced they would support the threshold being further reduced to $200,000.

Annual cap on concessional contributions: This measure has caused concern as it limits superannuation contributions (along with the non-concessional life time cap). However, when considered alongside the new rules which allow taxpayers to make contributions to age 74, and make catch-up contributions where a cap has been unused, some of these concerns then diminish. On this basis, we believe that the other parties could be convinced to support these changes.

Lifetime cap on non-concessional contributions: Since the announcement of the lifetime cap on non-concessional contributions dating back to 2007 was announced in the Federal Budget, the Coalition has been under significant pressure from both its own party room and by the ALP to make changes. The Government has said that it will extensively consult on a technical basis and has already announced that taxpayers with a self-managed super fund, who had entered into a contract before Budget night, which were relying on non-concessional contributions to complete the contract may be granted some sort of concession. The Treasurer has also indicated that some life events could also be a reason for an exception to the rules e.g. accident compensation. But generally, the Government is disinclined to make substantial changes. The ALP has advised that they will support this measure subject to it commencing on budget night (not back dated to 2007).

Treasurer Scott Morrison has already stated that those who would already exceed the cap had made an average $700,000 in non-concessional contributions and had average super balances of $2 million. "… in this environment where we're having to make changes across the board on the Budget, how you can run an argument which says that you've already put $700,000 in, you already have a super balance of $2 million, [so] we should allow another $500,000 on top of that." [*Interview with Jon Faine, ABC 774 on 27 July 2016*].

Low income superannuation tax offset: This measure is expected to have bi-partisan support, given the similarities between the ALP and Coalition policies.

For more information about the specific superannuation measures, please refer to our Tax Insights publication Federal Budget 2016-17 Superannuation Changes.

And what of Tax Reform?

The Tax Reform White paper process was announced by the then Opposition Leader in 2013. A 200 page discussion paper issued in March 2015 was followed by hundreds of submissions, and millions of words: written, spoken and argued. The results of the Tax Reform project so far are underwhelming and much is left to do to best advance the national interest.

The right Tax Reform policy solutions remain open to debate, and the political challenges will continue to frustrate the process. But the pressing reasons for Tax Reform which were articulated prior to the election remain pressing reasons today. Do we think that our tax system in 2016 will be the optimal tax system for Australia in 2030, or even in 2020? If we acknowledge that change is needed, and if we anticipate increasing challenges due to globalisation, digitisation and other transforming influences, it is not an option to let Tax Reform wither and die.

Other cross bench and party policy positions

Nationals		**ALP**	
	• Abandon backpacker tax		• Interest deductibility- support worldwide gearing ratio • Limit negative gearing • CGT discounts to 25% • $5k deduction cap for cost of managing tax affairs
Greens		**Nick Xenophon Team**	
	• Interest deductibility – support worldwide gearing ratio • Limit negative gearing • Progressive tax rate for superannuation contributions • Phase out the CGT discount to 0 over 5 years • Abandon backpacker tax • Additional multinational tax avoidance measures • Tax trusts as companies • Tax on sugar sweetened beverages		• Abandon backpacker tax • Speed up superannuation guarantee to 12% • Progressive taxation for superannuation contributions • Targeted tax breaks for companies in first 2 years of operation • “Modify” negative gearing through CGT reform
One Nation		**Derryn Hinch – Justice Party**	
	• Support removal of Double Tax Agreements • Want full review of the taxation system & bring back right of states to levy tax • Protection of superannuation		• Tax Policy not known
Jacqui Lambie Network		**Katters Australian Party**	
	• A financial transaction tax on high-speed share traders		• Scrap backpacker tax • Oppose any increase in the GST

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