Taking into account May 2019

Inside

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!

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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.

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.

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.

Changes to myGov account from 1 June 2019

The Government are making a few changes to myGov accounts from 1 June 2019. One of the changes we are excited to see is: - If you have a Tax or BAS agent, you may authorise them to designate their ATO online inbox to receive some or all of your ATO communications. This is a great change to the current system, whereby, once you setup your myGov account and link with the ATO, all communication goes to your myGov account, including your notice of assessment at year end. We don't even get any notification that your assessment has been issued. This has caused lots of headaches for us and our clients for the past few years, so we're very excited to see this change.

Your myGov inbox will remain your address for the ATO to send electronic communications that are not sent to your agent. - If you use secret questions and answers to confirm your identity, you should use myGov security codes or the myGov access app to improve your security. - If you currently use myGov security codes or myGov access app to confirm your identity you are all ready to go, as from 1 June 2019, it will be mandatory to use them to access ATO online.

A Labor Government on Tax & Super

Tax on investment property

In general, taxpayers are able to deduct from their assessible 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.

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.

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. The changes to the CGT discount will not apply to superannuation funds or to the 50 per cent active asset reduction concession that applies to small businesses."
- **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.

Dividend imputation and the impact on self-funded retirees

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.

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 dividend imputation system was introduced in 1987 by the Hawke/Keating Government to remove the investment bias against shares which taxed interest income once but dividend income twice (once at the company level on profits and the second time at the taxpayer level on income). In 2001, the Howard Government amended the rules to enable franking credits to be paid as a cash refund where the taxpayer paid less tax than the company tax rate. In the absence of refundability, the taxpayer pays tax up to the company tax rate and any surplus franking credit is wasted.

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. The policy effectively unwinds the Howard reforms and returns the imputation system to its original Hawke/Keating design.

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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:

- Individuals - shifting from shares to alternative investment arrangements (including to investments within superannuation), and couples shifting the ownership of shares from the lower income earner to the higher income earner such that the higher income earner can utilise the franking credits as a non-refundable tax offset.
- Superannuation funds - rolling assets from a fund with negative net tax to a fund with positive net tax, changing funds' asset portfolio allocations, or changing the membership structure of the fund, in order to maximise the utilisation of franking credits.
- Companies - changing the amount of dividends distributed (and profits withheld) or the level of dividend franking due to the decrease in the value of franking credits for some shareholders.

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."*

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.

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.

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.

No further details are available at present.

Tightening of superannuation framework

Mr Shorten told a media conference in April that the ALP had "no plans to increase taxes on superannuation." However, ALP policy does make 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, is $100,000, will be reduced to $75,000.
- 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 able to make additional 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 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 intend to unwind these reforms.