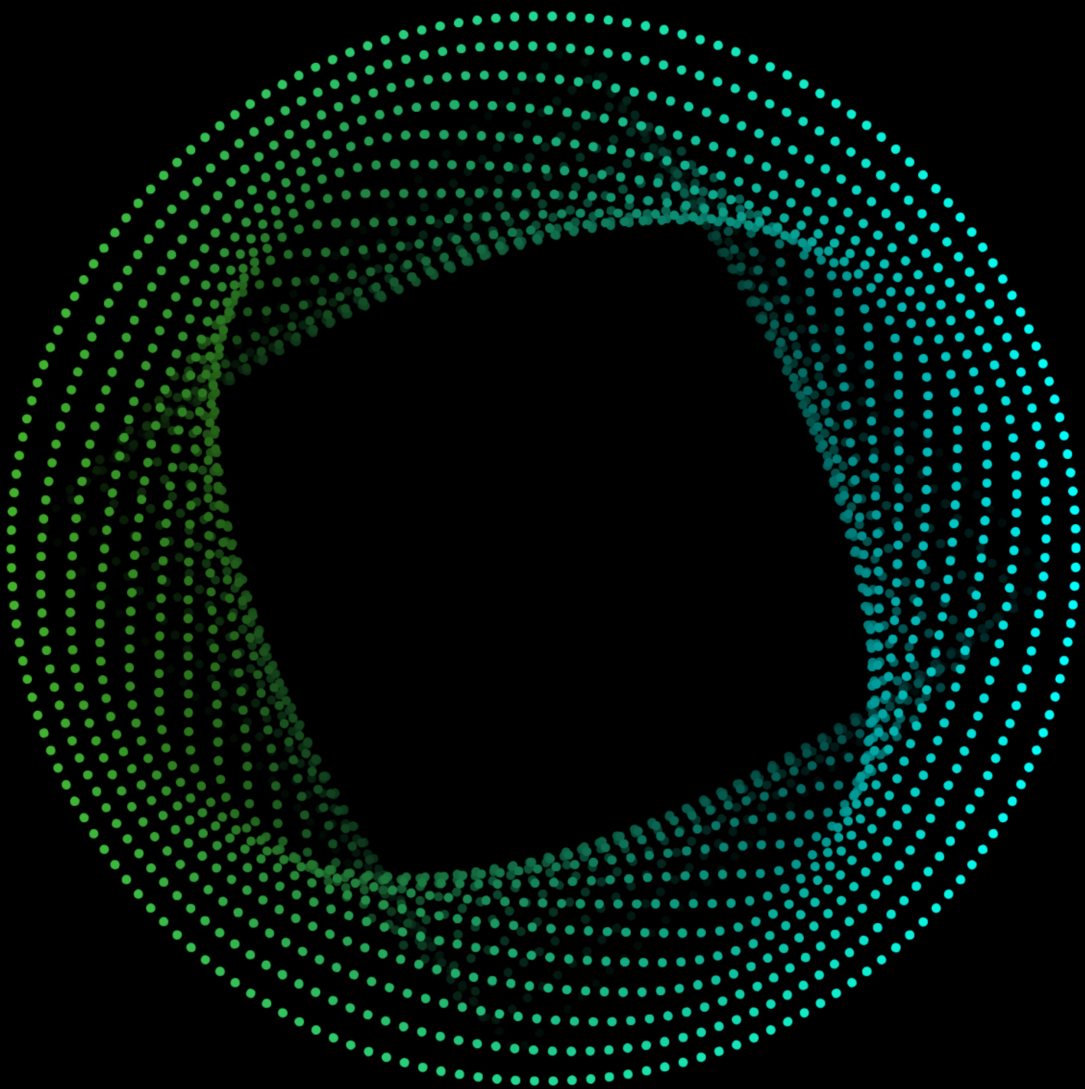
Deloitte.



The intersection of politics and prudence

Australian Federal Budget 2018-19

May 2018

Key measures

$billions to sweeten voters	Tax relief designed to appeal to low and middle-income voters with a four year targeted incentive, support for older Australians and a massive infrastructure spend are measures intended to sweeten voters
23.9% cap on tax-to-GDP	Revenue collected by the Government to be locked in at a maximum of 23.9% of GDP
$2.2 billion surplus	The Budget returns to surplus in 2019-20, a year earlier than expected in MYEFO
$200 - $530 "low and middle income tax offset" for 4 years from 1 July 2018	A new $200 tax offset will be available to workers earning $19,000 to $37,000, with it increasing to $530 for those with an income of $48,000. The full $530 offset will also apply to incomes from $48,001 to $90,000 (with it phasing out from $90,001). This is in addition to the existing "low income tax offset" entitlements
Marginal tax rate bracket overhaul	There will be adjustments to the marginal tax rate income brackets in the 2018-19, 2022-23 and 2024-25 years. Most significantly, in 2024-25, the 37% bracket will be abolished and the highest income tax bracket (45%) will apply to incomes exceeding $200,000
Improving the efficiency of superannuation	There are a number of measures designed to improve the efficiency and flexibility of the superannuation system
Company tax cuts	The Government remains committed to tax cuts for large corporates
Tightening of thin capitalisation measures	For income years commencing on or after 1 July 2019, all entities must rely on the asset values contained in their financial statements for thin capitalisation purposes. Additionally, foreign controlled Australian consolidated entities and multiple entry consolidated groups, that control a foreign entity, will be treated as both outward and inward investment vehicles (to ensure inbound investors cannot access tests only intended for outbound investors)
Multinational integrity measure – key definition broadened	The definition of a "significant global entity" will be expanded for income years commencing on or after 1 July 2018 to include members of large multinational groups headed by private companies, trusts, partnerships and investment entities
Higher proportionate spend on R&D to deliver higher incentive	For companies with annual turnover of $20 million or more, R&D tax incentive net benefits to be linked to the level of R&D intensity, with an increase in the annual expenditure cap (to $150 million)

	$4 million refundable R&D tax incentive cap	For companies with annual turnover below $20 million, R&D tax offset will be a premium of 13.5% above the applicable corporate tax rate. Annual refundable amounts limited to $4 million per annum
	$10,000 cash payment ban in black economy crackdown	The Government will introduce a limit of $10,000 for cash payments made to businesses for goods and services from 1 July 2019 as an anti-black economy measure
	Deduction denial for failure to withhold PAYG	Businesses will not be entitled to tax deductions for payments to employees and non-ABN contractors where they fail to properly withhold PAYG
	Taxable Payments Reporting System extended	The TPRS will be expanded to three sectors which are seen as high risk in the context of the black economy. From 1 July 2019, security providers and investigation services, road freight transport, and computer system design and related services will all be subject to the TPRS
	$4 million plus Government contracts need ATO certificate	From 1 July 2019, businesses with Australian Government procurement contracts over $4 million (including GST) will require an ATO compliance statement
	$20,000 "instant asset write–off" extended	The small business "instant asset write–off" has been extended for a further 12 months to 30 June 2019
	$24.5 billion infrastructure spend	Including $12 billion for road projects across capital cities and the regions, and $8 billion for capital city rail projects (including $5 billion for the Melbourne airport rail link)
	$3.6 billion extra Revenue from illegal tobacco	The ATO is to be funded to investigate evasion of duty and excise on tobacco products, plus taxes to be collected at borders, in a crackdown on illegal tobacco
	Significant funding allocated to emerging tax integrity risks and challenges	Additional funding for regulators, with the biggest funding relating to improving tax debt collections, the black economy, individual taxpayers and tax agents
	Countries added to reduced withholding tax list	From 1 January 2019, the list of countries whose residents are eligible to access the reduced MIT withholding tax rate of 15 per cent will be expanded to include additional information exchange countries
	50% CGT discount not available to MITs	From 1 July 2019, Managed Investment Trusts (MITs) and Attribution MITs (AMITs) will no longer be eligible to apply the 50% capital gains discount at the trust level

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Economic overview

Federal Budget 2018-19: One eye on a surplus, the other on the election

The noise out of Canberra in the lead up to the Budget really did ring true, this was clearly a pre-election Budget. Luckily for the Government, the tax take has been soaring, giving them the wriggle room to deliver some goodies.

Global economic growth is providing the most favourable backdrop for the Budget in years. Even better still, businesses and super funds have increasingly run out of their tax losses, meaning that a given economy is now generating more revenue.

This has allowed the Treasurer to bring off a trifecta – doing away with last year's announcement of an increase in the Medicare levy, delivering personal tax cuts from 1 July this year, and yet sneaking back into surplus a year earlier than the Government had earlier estimated.

All that and more, with a range of other measures in the Budget. For example, the Government announced some big ticket items in the form of new money for a range of infrastructure projects as well as funding for public hospitals, new drugs on the PBS and for the Great Barrier Reef, just to name a few.

On the whole the economic and Budget outlooks remain positive, with the caveat that the Treasurer has made additional promises (notably on tax) that may prove problematic for the return to surplus if the current surge in revenues eases back over the next couple of years.

Chris Richardson
Deloitte Access Economics

"It's all about personal income tax cuts tonight, with Budget repair now more reliant on an improving economy than on tough policy decisions."

The economy remains a Budget positive

The Australian economy is benefiting from the strongest and most synchronised global growth in years. While this has to some extent flowed through to higher real economic growth, most of the benefits have been in the form of a lift in national income growth thanks to higher commodity prices. Luckily for the Government, it is the latter which is more important for the Budget.

Treasury expects real output growth to gain momentum, rebounding from the low rate of 2.0 per cent in 2016-17 to be 2.75 per cent in 2017-18 and 3.0 per cent thereafter. The higher rate of growth is expected to translate into a gradual fall in the unemployment rate, reaching 5.0 per cent in 2021-22.

On the income front, there is even more good news. Elevated commodity prices are providing a boost to nominal income growth, particularly in the short term. While Treasury doesn't specifically forecast national income growth, it does set out its views on a close cousin – nominal GDP growth.

Treasury have pushed up its outlook for nominal GDP growth across 2017-18 but lowered it for 2018-19. Growth is expected to be 4.25 per cent in 2017-18, falling to 3.75 per cent the following year as commodity prices ease. This means that, compared with the forecasts it released just ahead of Christmas, Treasury now expects the size of the economy to be around $13 billion larger in 2017-18, with that gap narrowing to $9 billion in 2018-19.

Revenue collections to the rescue

So the strong economy is doing the Budget plenty of favours.

Company tax collections have come in well ahead of expectations thanks to higher commodity prices and many companies having now exhausted the losses they accrued back in the global financial crisis. This last factor is particularly important, as it has contributed to the weak company tax collections since the global financial crisis even during years of relatively strong profit growth. Treasury expects company tax collections to be the gift that keeps giving, with the economy providing a $3.7 billion boost to company tax collections out to 2020-21 compared to MYEFO.

The story on personal income taxes – which account for nearly half of total revenue – is more complicated. Strong employment growth thanks to the growing economy has contributed to a large increase in forecast collections. In the short term this is somewhat offset by continued weak wage growth. However, Treasury have not changed their wage forecasts from last December and continue to expect a pick-up in wage gains to 2.25 per cent in 2017-18 and 2.75 per cent in 2018-19, reaching 3.5 per cent in 2020-21 and 2021-22. This keeps expected personal income tax collections rising even with the announced tax cuts starting in on 1 July and the decision to reverse the planned increase in the Medicare levy.

2019-20, the long sought after surplus awaits?

The bottom line: higher revenue collections underpin the return to surplus.

The Budget balance is expected to improve significantly on the deficit of $33 billion in 2016-17. Treasury now expects a deficit of $18.2 billion in 2017-18 and $14.5 billion in 2018-19, before turning into a small surplus of $2.2 billion in 2019-20, growing to $11.0 billion in 2020-21 and $16.6 billion in 2021-22. Over the four years to 2020-21, this is an overall improvement in the figuring from MYEFO of around $12 billion.

The more positive short term Budget outlook sees Government net debt peak at 18.6 per cent of GDP in 2017-18, slightly better than what was expected at MYEFO last year.

The return to surplus is almost entirely due to higher revenue collections rather than reduced spending. In the 2017-18 Budget the Government dropped Plan A, achieving a surplus through spending cuts. Instead it opted for Plan B, with Budget repair via higher taxes – such as the new Bank levy and an increase in the Medicare levy.

This theme continues in 2018-19 with higher revenues due to a growing economy responsible for the return to surplus.

That places a cloud over the outlook presented here.

If Plan B relied on new and higher taxes, this Budget – Plan C – says that tax revenues will be up by enough to get the nation back to surplus – and to do so with tax cuts rather than tax increases.

The new plan may work, but it is vulnerable to economic and budgetary conditions. If the economy takes a dive, then the Budget outlook would dive alongside it. And the extended period of a promised-but-never-materialised return to surplus may linger even longer.

Individuals

Individuals

Tax cut for individuals

The Government will introduce a seven-year Personal Income Tax Plan.

Low and Middle Income Tax Offset

The Government will introduce a new Low and Middle Income Tax Offset for the 2018-19, 2019-20, 2020-21 and 2021-22 income years which will be received as a lump sum on assessment after an individual lodges their tax return.

Taxable Income ($)	Maximum Offset
Up to 37,000	Up to $200
37,000 to 48,000	$200 + 3 cents per dollar of income over $37,000
48,000 to 90,000	$530
90,000 to 125,333	$530 less 1.5 cents per dollar of income over $90,000

The benefit of the Low and Middle Income Tax Offset is in addition to the existing Low Income Tax Offset. The offset is restricted to Australian residents.

Making personal taxes simpler and flatter

The Government will change the personal tax rates and thresholds as follows:

Shelly Nolan
Global Employer Services

"The decision to grant modest personal tax cuts will be welcomed by low and middle income earners. The slow trajectory of the cuts satisfies the need for Budget restraint, whilst at the same time providing relief for bracket creep."

Rate (%)	Current tax thresholds Income range ($)	New tax thresholds from 1 July 2018 Income range ($)	New tax thresholds from 1 July 2022 Income range ($)	New tax thresholds from 1 July 2024 Income range ($)
Tax free	0-18,200	0-18,200	0-18,200	0-18,200
19	18,201- 37,000	18,201-37,000	18,201-41,000	18,201-41,000
32.5	37,000- 87,000	37,001-90,000	41,001-120,000	41,001-200,000
37	87,001 – 180,000	90,001-180,000	120,001-180,000	-
45	>180,000	>180,000	>180,000	>200,000

In addition, after 2021-22 the new Low and Middle Income Offset will be removed, and the Low Income Offset will be increased from $445 to $645. The increased Low Income Tax Offset will be withdrawn at a rate of 6.5 cents per dollar between incomes of $37,000 and $41,000, and at a rate of 1.5 cents per dollar between incomes of $41,000 and $66,667.

Medicare Levy and Medicare Levy Surcharge
The Medicare Levy will remain unchanged at 2 per cent of taxable income. The Levy was proposed to be increased to 2.5 percent from 1 July 2019, as announced in the 2017-18 Budget, to fund the National Disability Insurance Scheme (NDIS). Consequential changes to other tax rates that are linked to the top personal tax rate, such as the fringe benefits tax rate, will also not proceed.

Increasing the Medicare Levy Low-Income Thresholds
The Government will increase the Medicare levy low-income thresholds for singles, families, and seniors and pensioners from the 2018-19 income year.

Increased funding for the ATO for compliance activities
The Government will provide $130.8 million to the ATO from 1 July 2018 to increase compliance activities targeting individual taxpayers and their tax agents. The measure will also provide income matching activities, funding for new compliance activities, including additional audits and prosecutions, improving education and guidance materials, pre-filling of income tax returns and improving real time messaging to tax agents and individual taxpayers to deter over-claiming of entitlements, such as deductions by higher risk taxpayers and their agents.

Investing in national security agencies
This Budget will provide $130 million to upgrade Visa systems to improve screening of arrivals.

Business tax

Business tax

Corporate tax rate

The Government remains committed to reducing the Company tax rate to 25 per cent by 2026-27. The company tax rates currently legislated are shown below.

Previously announced measures

The Budget papers included a number of previously announced measures including:

- tax consolidation integrity measures (press release of 22 March 2018);
- taxation of financial arrangements (press release of 22 December 2017); and
- Stapled structures and related measures (press release of 27 March 2018)

Capital gains discount: Managed Investment Trusts

The Government will prevent Managed Investment Trusts (MITs) and Attribution MITs (AMITs) from applying the 50 per cent capital gains discount at the trust level. This measure will apply to payments made from 1 July 2019. This integrity measure will ensure that MITs and AMITs operate as genuine flow-through tax vehicles, so that income is taxed in the hands of investors, as if they had invested directly. This measure will prevent beneficiaries that are not entitled to the CGT discount in their own right from getting a benefit from the CGT discount being applied at the trust level. Under the measure, MITs and AMITs that derive a capital gain will still be able to distribute this income as a capital gain that can be discounted in the hands of the beneficiary.

Brett Greig
Business Tax Services

"To its credit and despite expending significant political capital to do so, the Government remains committed to legislating the second tranche of company tax cuts for large business."

Deny deductions for vacant land

Measures will be introduced to deny deductions for expenses associated with holding vacant land. This is an integrity measure to address concerns that deductions are being improperly claimed for expenses, such as interest costs, related to holding vacant land, where the land is not held for the purpose of earning assessable income. This measure will take effect from 1 July 2019.

Company tax rates	2017-18	2018-19	2019-20 through to 2022-23	2023-24	2024-25	2025-26	2026-27
Eligible company threshold (legislated)	$25 m	$50 m	$50 m	$50m	$50 m	$50 m	$50 m
Legislated Eligible company rate (per cent)	27.5	27.5	27.5	27.5	27.0	26.0	25.0
All other companies (legislated)	30	30	30	30	30	30	30.0
Eligible company rate (proposed)	n/a	n/a	27.5*	27.5#	27.0#	26.0#	25.0#

* Turnover threshold increasing annually to $100m, $250m, $500m, $1B
#No turnover threshold

Concessional loans between tax exempt entities

Where tax exempt entities become taxable after 8 May 2018, the Government will disallow tax deductions that arise on the repayment of the principal of a concessional loan. The deductions arise due to the unforeseen complex interaction between the taxation of financial arrangements rules and the rules dealing with deemed market values for tax exempt entities that become taxable.

Under this integrity measure, concessional loans that are entered into by tax exempt entities that become taxable will be required to be valued as if they were originally entered into on commercial terms.

Regulation of Company Auditors

The Government will provide $2.2 million over four years from 2018-19 for the Australian Securities and Investments Commission (ASIC) to strengthen the quality of listed entity financial reports.

Tax and superannuation debts

The Government will provide $133.7 million to the ATO to deliver on a range of strategies to pursue tax debts.

International tax

International tax

Claudio Cimetta
International Tax

"International tax steps out of the Budget spotlight this year. However, the ATO is actively administering a range of measures announced in recent years"

Thin capitalisation — valuation of assets and treatment of consolidated entities

The ATO has recently identified concerns regarding the revaluation of assets, for thin capitalisation purposes. The Government has responded to this by tightening of Australia's thin capitalisation rules. The proposed measure will require entities to align the value of their assets for thin capitalisation purposes with the value included in their financial statements. This means that companies will no longer be able to revalue assets "off-balance sheet" for thin capitalisation purposes only. This measure will apply to income years commencing on or after 1 July 2019. Valuations that were made prior to the Budget may be relied upon until the beginning of the first income year commencing on or after 1 July 2019.

In addition, the Government has announced a technical measure dealing with inbound / outbound structures. This will apply to foreign controlled consolidated and multiple entry groups that control a foreign subsidiary. Such groups are to be treated as both an outward and inward investment vehicle, with the intention of ensuring that inbound investors cannot access tests that were intended only for outward investors. The measure will commence for income years commencing on or after 1 July 2019.

Significant global entity definition amendment

For income years commencing on or after 1 July 2018, the Government is to broaden the definition of a significant global entity (SGE)). SGEs are subject to additional disclosures and integrity measures such as Country-by-Country reports, the Multinational Anti-Avoidance Law and the Diverted Profits Tax.

The current definition applies only to an entity which is a member of a group headed by a public company or a private company required to provide consolidated financial statements.

The definition will be broadened to include members of large multinational groups headed by private companies, trusts and partnerships. It will also include members of groups headed by investment entities.

This measure will also ensure the Commissioner's power to determine an entity to be an SGE parent operates as intended.

Updating the list of information exchange countries

The Government will update the list of countries whose residents are eligible to access a reduced withholding tax rate of 15 per cent, instead of the default rate of 30 per cent, on certain distributions from Australian Managed Investment Trusts (MITs).

The update will add the 56 jurisdictions that have entered into information sharing agreements since 2012. The updated list will be effective from 1 January 2019.

Action in respect of the Digital Economy

On 16 March 2018, the OECD released its interim report on the Tax Challenges arising from Digitalisation. Off the back of this report, the Treasurer announced a commitment to work with the OECD to redesign the way the digital economy is taxed.

On Budget night, the Treasurer confirmed that he will be releasing a discussion paper shortly that will explore options for taxing digital business in Australia.

Small business

Small business

Spyros Kotsopoulos
Deloitte Private

"The Government continues its' focus on easing the burden on small business with an extension to the instant asset write off for a further 12 months to 30 June 2019."

Extension of the small business instant asset write-off

The Government will extend the $20,000 instant asset write-off by a further 12 months to 30 June 2019 for businesses with an aggregated annual turnover of less than $10 million. Small businesses will continue to be able to immediately deduct purchases of eligible assets costing less than $20,000 first used or installed ready for use by 30 June 2019. Similar to previous announcements, certain assets are excluded.

Clarifying the operation of the Division 7A integrity rule

From 1 July 2019, the Government will ensure that unpaid present entitlements come within the scope of Division 7A of the *Income Tax Assessment Act 1936.* This means that these amounts could be taxed as dividends unless they are structured as Division 7A complying loans or another exception applies.

The Government will also defer the start date of the targeted amendments to Division 7A that were announced in the 2016-17 Budget which were originally to commence from 1 July 2018 to a new start date of 1 July 2019. This will enable all Division 7A amendments to be progressed as part of a consolidated package.

Denial of small business CGT concessions to partners who alienate income

The Government has announced that from 7:30PM (AEST) on 8 May 2018, partners that alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership will no longer be able to access the small business capital gains tax (CGT) concessions in relation to these rights.

Extending anti-avoidance rules for circular trust distributions to family trusts

From 1 July 2019 the Government will extend to family trusts a specific anti-avoidance rule that applies to other closely held trusts that engage in circular trust distributions.

Integrity measure for minor beneficiaries of testamentary trusts

From 1 July 2019, the concessional tax rates available for minors receiving income from testamentary trusts will be limited to income derived from assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets.

Infrastructure

Infrastructure

Luke Houghton
Infrastructure and Transport

"The Budget provides more clarity on the Government's $75.0 billion infrastructure roll-out plan, and new rail and upgraded roads are clear winners, in an effort to bust congestion and improve safety."

New infrastructure commitments

This year's Budget confirmed that the 10-year $75.0 billion infrastructure plan announced last year will continue, and earmarked $24.5 billion to new rail and road upgrade projects across Australia over the next decade.

Effectively, the Budget announcement provides more detail on the projects that are likely to receive funding as per last year's commitment, rather than additional funding over and above what had already been announced last year.

Of the $24.5 billion announced in this year's Budget, $4.2bn will be spent in the next four years, reflecting the fact many projects are not ready for construction. Existing projects will get $17.8 billion over the next four years.

The primary objectives of these multi-billion dollar investments are to reduce congestion on our roads and improve road safety, which is reflected in the larger allocation of funds towards road project's in the 2018 Budget. Of equal importance is the objective to provide improved transport accessibility for the growing Australian population to jobs and services.

Key funding commitments include:

Transport

- Victoria – $5.0 billion for the Melbourne Airport Rail Link, $1.8 billion for the North-East link motorway in Melbourne and $475.0 million for a rail connection to the Monash precinct;
- Western Australia – $1.7 billion for road projects across the State and an extra $1.1 billion for the Perth Metronet project;
- Queensland – $1.0 billion for an upgrade of the M1 motorway on the Gold Coast, $390.0 million for the duplication of the North Coast rail line between Beerburrum and Nambour and $300.0 million for Brisbane City Council's Metro scheme;
- New South Wales – nearly $1.0 billion for a Coffs Harbour bypass on the Pacific Highway, $400.0 million for the Port Botany rail duplication in Sydney, $155.0 million for a four-lane bridge over the Shoalhaven river at Nowra and the commitment to part fund the business case for the proposed North-South Rail link ($50 million) marks the first significant milestone in the Federal Government's City Deals agenda;
- South Australia – $1.2 billion for the North-South corridor in Adelaide, $220.0 million to electrify the Gawler rail line and $160.0 million to duplicate the Joy Baluch Bridge in Port Augusta;
- Tasmania – $461.0 million for the development of a replacement Bridgewater Bridge in Hobart;
- $3.5 billion to establish the Roads of Strategic Importance initiative to support the upgrade of key regional road corridors in Australia, with initial investments to include: $1.5 billion for Northern Australia (Queensland, Northern Territory and Western Australia), $400.0 million for Tasmanian road corridors, including the Bass Highway, $220.0 million for the Bindoon Bypass in Western Australia, and $100.0 million for further upgrades of the Barton Highway corridor linking the Australian Capital Territory and New South Wales; and
- $1 billion to establish the Urban Congestion Fund which will support projects to remediate pinch points, improve traffic safety and increase network efficiency for commuter and freight movements in urban areas.

Community infrastructure

- $206.5 million over four years from 2018-19 for round three of the Building Better Regions Fund, to support investment in community infrastructure and capacity building projects in regional areas
- $154.3 million over five years from 2017-18 to support the Government's goal of building a more active Australia

Healthcare
- $189 million for hospital infrastructure in Western Australia

Housing
- $550 million for remote Indigenous housing in the Northern Territory.

The Federal Government has also emphasised a focus on projects in which it is an equity partner, such as the Melbourne Airport rail project, for which the Budget assumes a 50-50 partnership with the Victorian Government. This provides a clear message of intent, at the federal level, for more active collaboration across the various tiers of government with respect to major transformational projects.

Other recent examples of project partnerships across the three levels of government include:
- The 20-year multi-billion Western Sydney City Deal, signed in March 2018
- The 5-year Launceston City Deal, signed in April 2017
- The 15-year Townsville City Deal, signed in December 2016,
- Other City Deals currently under negotiation, including City Deals for Hobart, Geelong, Perth and Darwin.

Key messages

The funding commitment is for an array of projects covering capital cities and the regions, and will provide a boost to employment within the construction, transport and professional services sectors, positioning these regions for improved economic growth and productivity in the medium to long term.

This investment activity will provide the momentum to an economy currently faced with low levels of business investment, modest growth in consumer spending and the recent slowdown in housing construction.

They key to note however, is that State Governments will need to provide additional funding on top of the Federal Government's commitments to deliver these initiatives. This will require the states to find innovative funding mechanisms and explore opportunities for value sharing. State governments will need higher Budgets to operate and maintain the new assets once delivered.

Equally important is to remember that this is a pre-election Budget, where much of the commitments are for projects without a business case and without finalised costings (e.g. Melbourne Airport link and most of the Western Australian projects). As a consequence, it is not clear if the actual spend and turnout will be similar to pledges.

The current construction boom in most states also brings into question the market's capacity to deliver all of these projects concurrently without putting a significant upward pressure on wages and prices.

Investment and innovation incentives

Investment and innovation incentives

As flagged by the Treasurer in the lead up to the Budget, the benefits available under the R&D Tax Incentive program were narrowed, with the Government responding to the Review of the R&D Tax Incentive (the Review), originally released in September 2016.

Overall, the Budget announcements have largely endorsed most of the recommendations that were made by the Review with the higher cap on annual refunds that was suggested by the 2030 Innovation & Science Australia Strategic Plan, released in January 2018, being adopted. However, surprisingly, the Budget announcements did not include the introduction of a previously mooted 20 per cent collaboration premium aimed at increasing collaboration between companies and research bodies.

The proposed changes will take effect for income years commencing on or after 1 July 2018.

Greg Pratt
Global Investment & Innovation Incentives (Gi3)

"The R&D benefit for many low intensity R&D industries will be reduced going forward, with a focus on incentivising more intensive industries"

Proposed changes to refundable R&D tax offset

Annual refund cap announced

The Budget announcements confirmed the recommendation of an annual cap on refunds of $4 million per annum, with any remaining offset amounts being carried forward but treated as non-refundable tax offsets. This means that offsets exceeding the annual cap cannot be cashed out in subsequent income years where the annual cap for that respective year is not reached. Taxpayers may consider planning R&D activities accordingly to maximise the refund opportunities available against these annual caps.

Critically, eligible expenditure on clinical trials has been scoped out of the cap given the acknowledged opportunities for growth in the medical technology, biotechnology and pharmaceutical sectors. The announcement also alluded to amendments to the general anti-avoidance provisions.

The recommendation for a maximum cumulative refund cap was not announced, potentially due to the complicated tracing provisions that would be required. However, the proposal may still dismay start-ups with notional cash refunds under the refundable offset provisions in excess of $4 million per year that face difficulties in obtaining initial funding, often for long and intensive R&D programs.

Net tax benefit decoupled from corporate tax rate

Despite the net tax benefit of the R&D Tax Incentive having been deliberately decoupled from the corporate tax rate since 2011, the current progressive reductions in corporate tax rates have resulted in the Treasurer effectively announcing a recoupling of the two.

For the refundable tax offset, available to companies with an aggregate turnover of less than $20 million, the rate of the tax offset will be reduced from a flat 43.5 per cent to a rate of 13.5 per cent over the prevailing corporate tax rate (currently at either 30 per cent or 27.5 per cent). This means that eligible companies will no longer see incremental increases in the net after tax benefit arising from falling corporate tax rates.

Proposed changes to non-refundable R&D tax offset

As foreshadowed, an intensity threshold for the non-refundable component of the incentive was announced, with a view to encouraging incremental R&D. The Government has announced a concept of tiered "R&D premiums" that will replace the concept of a flat R&D tax offset rate and commensurate after tax benefit.

The measure will seek to tie the amount of the non-refundable R&D tax offset to the incremental **intensity** of R&D expenditure of an entity – calculated as a proportion of total expenditure for the income year. In line with these changes, the R&D expenditure threshold will be increased from $100 million to $150 million per annum (with a current sunset period of 30 June 2024).

Very broadly, there will be tiered thresholds whereby higher levels of R&D expenditure compared to total expenditure will attract higher rates of R&D premiums. This means that companies with a low R&D intensity will receive a reduced benefit going forward, whilst other companies that have a high R&D intensity may receive an increased benefit.

Effectively, one or more marginal R&D premiums will be calculated in accordance with the following table, and the premium will be added to a company's prevailing corporate tax rate to calculate the tax offset amounts:

R&D intensity rate *	R&D offset premium (added to prevailing corporate tax rate) ^
Less than 2 per cent	4 per cent for R&D expenditure between 0 - 2 per cent R&D intensity
Between 2 and 5 per cent	4 per cent for R&D expenditure between 0 - 2 per cent R&D intensity; plus
	6.5 per cent for R&D expenditure above 2 per cent to 5 per cent R&D intensity
Between 5 and 10 per cent	4 per cent for R&D expenditure between 0 - 2 per cent R&D intensity; plus
	6.5 per cent for R&D expenditure above 2 per cent to 5 per cent R&D intensity; plus
	9 per cent for R&D expenditure above 5 per cent to 10 per cent R&D intensity
Over 10 per cent	4 per cent for R&D expenditure between 0 - 2 per cent R&D intensity; plus
	6.5 per cent for R&D expenditure above 2 per cent to 5 per cent R&D intensity; plus
	9 per cent for R&D expenditure above 5 per cent to 10 per cent R&D intensity; plus
	12.5 per cent for R&D expenditure above 10 per cent R&D intensity

* Calculated as R&D expenditure / Total expenditure (yet to be defined)

^ Premium added to prevailing corporate tax rate to calculate R&D tax offset rate for that 'slice' of expenditure

For any eligible expenditure in excess of $150 million, the R&D offset premium will be Nil.

The mechanism adopted is not as blunt as anticipated, but may still unduly discriminate against companies with high levels of general "total expenditure", largely in industries such as mining, manufacturing and fast moving consumer goods (FMCG).

Indeed, unless a base or prior year threshold is adopted in the final legislation, companies will be tracking a moving target. Regardless of how total expenditure is defined, this will undoubtedly create uncertainty in forecasting the availability of the incentive each year.

The announcements confirmed that the feedstock and grant clawbacks will be amended, as they currently claw back a flat rate benefit of 10 per cent, which is unsustainable in light of the substantially reduced benefits.

Administrative R&D announcements

On the remaining recommendations made by the Review, it appears that the Government has chosen to:

- Retain the current definition of eligible R&D activities and expenses, but has committed to developing further guidance to provide more clarity regarding the scope of these;
- Increase resources to improve the administration and integrity of the R&D tax incentive; and
- Improve transparency by providing the ATO with the option of publishing the names of companies claiming the incentive and the quantum of R&D expenditure claimed annually – it is not yet clear whether this will involve the disclosure of all claims, or like the current annual tax transparency reports, be limited to larger entities.

Deloitte views

With the net tax benefit of R&D claims now being markedly below the original rates of 40 and 45 per cent respectively for non-refundable and refundable offset claims, the overall attraction of the R&D Tax Incentive has been substantially diminished since its introduction in 2011.

That said, the impact of the 'relaunched' program is less detrimental than was anticipated by some, in particular the life-sciences sector. Benefits are still available through making robust and substantiated claims, especially for industries with higher levels of R&D intensity.

It is certainly hoped that this round of legislative amendments will be the last for a significant period of time. Confidence in the longevity of the program needs to be restored for those taxpayers that seek to claim the R&D Tax Incentive, and factor the program's benefits into making critical innovation investment decisions.

Going forward, companies that currently claim the R&D Tax Incentive, or plan to do so, should now:

- Consider any planned R&D expenditure on a regular basis to assess potential breaches of the proposed refund cap; and
- Undertake a review of R&D expenditure against broad annual business expenditures over last 5 years to assess the potential impact of the new eligibility test

Black economy

Black economy

Tax integrity package – Black Economy Taskforce
The Government released the final report of the Black Economy Taskforce.

Further expansion of taxable payments reporting
Further to the previous rollouts of the taxable payment system (TPRS) to contractors in the building and construction, cleaning and courier services industries, from 1 July 2019 the Government will further expand the TPRS to the following industries:
- Security providers and investigation services;
- Road freight transport; and
- Computer system design and related services.

Introduction of an economy-wide cash payment limit
The Government will introduce an economy-wide cash payment limit of $10,000, applying to payments made to businesses for goods and services from 1 July 2019.

As a result, transactions over the threshold will be required to be made through an electronic payment system or via cheque. Transactions with financial institutions or consumer to consumer non-business transactions will not be affected.

Non-compliant payments to be non-deductible
From 1 July 2019, businesses will no longer be able to claim deductions for payments to:
- Employees where they have not withheld any amount of PAYG from these payments, despite the PAYG withholding requirements applying
- Contractors where the contractor does not provide an ABN and the business does not withhold any amount of PAYG despite the withholding requirements applying.

David Watkins
Tax Insights & Policy

"The Government's Black Economy announcements represent a shift in focus to address tax and other risks in a growing, but until now, overlooked sector of the economy."

Increasing the integrity of the Commonwealth procurement process
From 1 July 2019, businesses seeking to tender for Australian Government procurement contracts over $4 million (including GST) will be required to provide a statement from the ATO indicating that they are generally compliant with their tax obligations.

The Government will provide $9.2 million over four years from 2018-19 to the ATO to develop and consult on a Procurement Connected Policy.

ATO enforcement
The Government will also provide $318.5 million over four years to implement new and enhanced enforcement strategies to combat the black economy which will include:
- New mobile strike teams
- An increased audit presence
- A Black Economy Hotline that will allow for the community to report black economy and illegal phoenix activities
- Improved Government data analytics, and
- Educational activities.

Multi-Agency Taskforce and Treasury Implementation

The Government will provide $3.4 million to the ATO to lead a multi-agency Black Economy Standing Taskforce. The Taskforce will facilitate a cross-agency approach to combatting the black economy.

In addition, the Government will provide $12.3 million over five years from 2018-19 (with $1.7 million in 2022-23) to Treasury to manage implementation of the whole-of-Government response to the Black Economy Taskforce Report. The Minister for Revenue and Financial Services will shortly be releasing consultation papers on a number of work streams being progressed by the Implementation Team.

Delivering Australia's Digital Future — modernising business registers

The Government will provide additional funding to develop a detailed business case for modernising the Government's business registers.

Consulting on a new regulatory framework for Australian Business Numbers

The Government will consult on and design a new regulatory framework for the Australian Business Numbers (ABN) system.

Reforms to combat illegal phoenixing

The Government has announced that it will reform the corporations and tax laws and provide the regulators with additional tools to assist them to deter and disrupt illegal phoenix activity. The package includes reforms to:

- introduce new phoenix offences to target those who conduct or facilitate illegal phoenixing
- prevent directors improperly backdating resignations to avoid liability or prosecution
- limit the ability of directors to resign when this would leave the company with no directors
- restrict the ability of related creditors to vote on the appointment, removal or replacement of an external administrator
- extend the Director Penalty Regime to GST, luxury car tax and wine equalisation tax, making directors personally liable for the company's debts; and
- expand the ATO's power to retain refunds where there are outstanding tax lodgements.

New measures to tackle the illicit tobacco trade

The Government has announced new measures to tackle the illicit tobacco trade including:

- The establishment of a new multi-agency Illicit Tobacco Taskforce led by Australian Border Force.
- From 1 July 2019, importers will be required to pay all duty and tax liabilities when tobacco enters the country, rather than when it leaves a licensed warehouse and enters the domestic market
- From 1 July 2019 it will also be illegal to import tobacco without a permit
- The ATO will be provided with additional resources to fight domestic illicit tobacco and upgrade their entire excise systems.

Indirect tax

Indirect tax

GST changes for offshore sellers of online hotel bookings

Currently, offshore sellers of Australian hotel accommodation are exempt from including sales of hotel accommodation in their GST turnover. As a result, they are often not required to register for and charge GST on their mark-up over the wholesale price of the accommodation. This exemption was introduced in 2005, when most offshore sales of Australian hotel rooms were to foreigners booking through offshore tour operators, and the online booking market was small.

From 1 July 2019, the Government will require offshore sellers of hotel accommodation in Australia to include sales made on or after this date in their GST turnover in the same way as local sellers. Sales that occur before 1 July 2019 will not be subject to the measure even if the stay at the hotel occurs after this date.

This change will require the unanimous agreement of the States and Territories prior to the enactment of legislation.

Removing luxury car tax on re-imported cars following refurbishment overseas

At the present time, cars that are refurbished in Australia are not subject to luxury car tax. However, cars exported from Australia to be refurbished overseas and then re-imported are subject to the tax where the value of the car exceeds the relevant luxury car tax threshold.

From 1 January 2019, the Government will remove luxury car tax on cars re-imported into Australia, following a refurbishment overseas.

Alcohol excise changes announced

On 4 May 2018, the Treasurer announced two measures directed at assisting manufacturers of excisable alcohol beverages:

- From 1 July 2019, the 'alcohol excise refund scheme' cap will be increased to $100,000 per financial year, and become available to all brewers and distillers. Under current arrangements, manufacturers of excisable alcoholic beverages (for example, beer, spirits or other fermented beverages such as non-traditional cider) who satisfy certain eligibility requirements, can claim a refund of 60 per cent of the excise duty they have paid on their products, up to the current cap of $30,000.
- From 1 July 2019, the concessional draught beer excise rates currently applicable to beer sold in kegs larger than 48 litres will be extended to kegs of 8 litres or more. For example, under current arrangements, beer containing over 3.5 per cent alcohol by volume, sold in a 48+ litre keg, is subject to excise at the rate of $34.87 per litre of alcohol, while the same beer sold in a smaller keg is subject to excise of $49.50 per litre of alcohol. The change is expected to benefit craft brewers many of whom prefer to use smaller kegs to meet the preference of smaller venue customers such as cafes and restaurants.

John Koutsogiannis
Indirect Tax

"Having made several changes to the GST law in the past year or two to protect GST revenue in relation to imports, real property and precious metals, the Government is now focusing its attention on addressing black economy threats to indirect tax collections, and also providing some excise assistance in the small business sector."

Superannuation

Superannuation

The Government has introduced a number of measures to increase the flexibility of rules around superannuation.

Work test exemption for recent retirees

Currently, the work test restricts the ability for those aged 65 to 74 to make voluntary superannuation contributions unless they work a minimum of 40 hours in any 30-day period in the financial year.

To provide retirees with additional flexibility, from 1 July 2019 the Government will introduce an exemption from the work test for people aged 65-74 with superannuation balances below $300,000, in the first year that they do not meet the work test requirements.

Increasing the maximum number of allowable members in self-managed superannuation funds and small APRA funds

From 1 July 2019, the Government will increase the maximum number of allowable members in new and existing self-managed superannuation funds and small APRA funds from four to six.

The aim of this measures is to provide greater flexibility for joint management of retirement savings, in particular for large families.

Option to nominate wages are not subject to SGC

The Government announced a measure designed to allow eligible individuals to avoid unintentionally breaching the $25,000 annual concessional contributions cap as a result of multiple compulsory superannuation guarantee contributions. A breach of the cap can result in a liability for excess contributions tax, together with a shortfall interest charge.

Accordingly, from 1 July 2018, individuals whose income exceeds $263,157 who have multiple employers will be able to nominate that their wages from certain employers are not subject to superannuation guarantee (SG).

Relaxation of annual audit requirement for certain SMSFs

From 1 July 2019, self-managed superannuation funds (SMSFs) with a history of good record keeping and compliance will no longer be required to commission an annual audit, and instead be required to commission audits on a three-yearly cycle.

Meghan Speers
Superannuation - Tax

"After the significant level of changes to the superannuation regime in 2016, the Government has taken the opportunity to both relax some of the rules to make superannuation more accessible and put in measures to protect superannuation balances."

To be eligible, SMSF trustees must have a history of three consecutive years of clear audit reports and have lodged the fund's annual returns in a timely manner. The Government will consult with stakeholders to ensure smooth implementation.

Superstream to accept SMSF rollovers

In a pre-Budget announcement, the Government advised that Superstream (the Governments electronic payment system for superannuation) will be extended to include SMSF rollovers, allowing SMSF members to initiate and receive rollovers electronically between an APRA fund and their SMSF.

A number of measures were also announced to safeguard and protect superannuation balances from undue erosion.

Capping passive fees, banning exit fees and reuniting small and inactive superannuation accounts

From 1 July 2019, the Government will:

- Introduce a three per cent annual cap on passive fees charged by superannuation funds on accounts with balances below $6,000 and
- Will ban exit fees on all superannuation accounts.

Also from 1 July 2019, all inactive superannuation accounts where the balances are below $6,000 will be required to be transferred to the ATO. The ATO will expand its data matching processes to reunite these inactive superannuation accounts with the member's active account, where possible. This measure will also include funds currently held by the ATO. Treasury estimates that the majority of accounts transferred to the ATO will be reunited in the year they are received.

Changes to insurance within superannuation funds

From 1 July 2019, insurance products within superannuation will move from a default framework to be offered on an opt-in basis for:

- Members with low balances of less than $6,000;
- Members under the age of 25 years; and
- Members whose accounts have not received a contribution in 13 months and are inactive.

The changes aim to ensure that superannuation balances are not unnecessarily eroded by premiums that members may not need or may not be aware of.

In addition, the Government will consult publicly on ways in which the current policy settings could be improved to better balance the priorities of retirement savings and insurance cover within super.

Comprehensive income products in retirement

The Government will amend the *Superannuation Industry (Supervision) Act 1993* to introduce a retirement covenant that will require superannuation trustees to formulate a retirement income strategy for superannuation fund members.

The Government will also amend the *Corporations Act 2001* to introduce a requirement for providers of retirement income products to report simplified, standardised metrics in product disclosure to assist customer decision making.

Enhancing Female Financial Capability

In 2018-19, the Government will provide $10.0 million to the Australian Securities and Investments Commission in 2018-19 to provide a grant that will support initiatives to enhance female financial capability.

Improvements to the integrity of deductions for personal contributions

Currently, individuals claiming a deduction for personal superannuation contributions are required to submit a "notice of intent" to their superannuation fund, so that the fund pays and applies a 15 per cent contribution tax to their contribution. Some individuals do not submit a NOI, despite being required to do so.

From 1 July 2018, the Government will provide $3.1 million to the ATO over the forward estimates to improve the integrity of the 'notice of intent' (NOI) processes for claiming personal superannuation contribution tax deductions.

The additional funding will enable the ATO to develop a new compliance model, and to undertake additional compliance and debt collection activities.

Full Cost Recovery of Superannuation Activities

In order to fully recover the cost of superannuation activities undertaken by the Australian Taxation Office, the Government will raise additional revenue of $31.9 million over four years from 2018-19 by increasing the Financial Institutions Supervisory Levies.

Education and training

Education and training

The 2018-19 Budget is a consolidation of existing policy positions from the Australian Government, across all education sub-sectors. In doing so, the Government is continuing its shift in focus, from how much we spend on education, to the quality of education, and the outcomes for students.

Colette Rogers
Education and Training

"This year's Budget consolidates the Government's existing stance on funding reform across the education sector. In doing so, the Government is continuing its shift in focus, from how much we spend on education, to the quality of education, and the outcomes for students."

Early childhood education

The introduction of the new Child Care Package on 2 July 2018 replaces the existing two child care payment system with a single *Child Care Subsidy* payment.

There continues to be uncertainty regarding the long term future of early childhood education funding under the National Partnership on Universal Access to Early Childhood Education. The Budget reconfirmed a commitment to funding through until the end of 2019.

An additional $11.8 million over three years will be provided to expand the *Early Learning Languages Australia* program to more preschools and to trial the programs in 2019 and 2020 from foundation through to year 2 in primary schools.

Schooling

2017-18 saw a significant focus on finalising new and ongoing school funding arrangements for all schooling systems and jurisdictions, with an emphasis on consistent and needs-based funding provided to all schools.

With these funding arrangements re-affirmed in the 2018-19 Budget, the Government is continuing its shift in focus from funding, towards implementing the recommendations set out in the recent Gonski 2.0 report.

Vocational Education and Training

The Australian Government will provide $1.2 billion over the four years to 30 June 2022 for the Skilling Australians Fund which provides support for apprenticeships and traineeships. State and Territory Governments will be asked to work with the Australian Government to develop a new agreement to support revised implementation arrangements.

Higher education

The 2017-18 MYEFO saw the Government announce significant funding reforms to universities, with a two-year freeze placed on the Commonwealth Grants Scheme to universities and a cap on funding for student places.

This was in addition to changes to the HECS-HELP scheme, which reduced the minimum threshold for tuition fee repayments to $45,000 per year.

While the Government has yet to be passed by the Senate, the 2018-19 Budget retains these reforms, with the Government doubling down on their attempt to realise savings from their expenditure on the higher education portfolio.

The 2018-19 Budget saw the announcement of a number of new initiatives, including the introduction of partial cost recovery arrangements on providers for the *Higher Education Loan Program* (HELP), which will come into effect from 1 January 2019. This will include an annual charge and application fee applied to all HECS-HELP and FEE-HELP approved course providers.

The Budget also announced increased investment in regional university campuses, in the form of additional study places for a limited number of regional universities. Building on the initiative announced in the 2017–18 Budget, the Government will provide $28.2 million to expand access to sub-bachelor programs in regional areas, and $14.0 million to fund additional places for bachelor students studying at Regional Study Hubs.

The Government will also provide an additional $1.9 billion over 12 years from 2017-18 ($393.3 million over five years) to implement the Research Infrastructure Investment Plan (the Plan), informed by the 2016 National Research Infrastructure Roadmap.

Health & human services

Health & human services

Budget report summary

The Budget sees significant investment in health and care with a particular focus on three areas:

- Aged care – a range of measures recognising our ageing populations and helping older Australians live longer and more independently at home, rather than being admitted to residential aged care facilities
- Mental health – in younger and older Australians
- Core health services – including GP service support, hospital funding, access to drugs and research to support further medical developments

Aged care

Investment in aged care had been announced prior to the Budget but the level and nature of the announcements go further than was expected – with a real recognition of the importance of remaining independent and well and staying closer to homes and communities. Whilst not explicitly stated, this investment also recognises the ageing demography in Australia, like in many other countries, and the impact this could have, coupled with the onset of chronic rather than acute illnesses, on demand and the sustainability of traditional healthcare facilities including hospitals and aged care facilities.

Beyond this, there is significant research that demonstrates that living at home is better for elderly people both in terms of their health outcomes and happiness. Action to support this objective is positive, focused on what matters to older Australians and is consistent with international directions of travel.

The Government has invested in a number of supporting initiatives including aged care packages (home care support and social care); combatting loneliness in ageing; investment in older people's mental health care, more support for those living in rural and remote communities; culturally safe aged care services in remote Indigenous communities; the establishment of the Aged Care Quality and Safety Commission to ensure older Australians receive the best possible care; improvements to the MyAged Care on-line system for assessing and accessing care and further investment in end of life care.

Mental health

Mental health is a critical and sometimes overlooked component of Australians' overall wellbeing and ability to live independent and fulfilling lives. The Government is investing an additional $338.1 million in mental health funding, with a focus on suicide prevention, research, care for older Australians and advancing the Fifth National Mental Health and Suicide Prevention Plan. It will also expand initiatives with Beyondblue; Lifeline Australia; SANE Australia a new Million Minds Mission through the Medical Research Future Fund. Over the next 10 years, $125 million will be invested in new research to support an additional million people with mental illness, through new research, diagnosis and treatment.

Dr Stephanie Allen
Health & Human Services

"The Commonwealth has led the way with more consumer directed care for disability and aged care services - putting recipients at the heart of what's done and how, and placing a greater focus on wellbeing and out of hospital care. With increased ageing and chronic conditions, the Commonwealth, States and Territories will have to continue to develop innovative ways to deliver high quality healthcare at a lower cost."

Core health services

The Government will provide an additional $4.8 billion investment to Medicare – the scheme that pays for Australians' general practice (GP) visits and a number of other medical procedures. Medicare spending is guaranteed and increasing every year to 2021-22.

Following recent independent reviews of Medicare, new support will be provided for renal dialysis in remote communities, MRI scans for prostate cancer checks, a new cutting-edge 3D mammography test for the early detection of breast cancer and new genetic testing for cystic fibrosis. Further support will be provided, through the Pharmaceutical Benefits Scheme (PBS) to a number of life-saving and life-improving medicines.

The Government will deliver more than $30 billion in additional public hospital funding under a five-year National Health Agreement, with funding increasing for every state and territory, every year. From 2020-21 to 2024-25, the new agreement will deliver a record $130.2 billion in public hospital funding.

Medical research will see significant funding increases with $6 billion in record funding for Australia's health and medical research sector, including $3.5 billion for the National Health and Medical Research Council, $2 billion in disbursements from the Medical Research Future Fund and $500 million from the Biomedical Translation Fund. Clinical trials offer the hope of better diagnosis, treatment and ultimately cures and the Budget provides $248 million to support clinical trial activity through the highly successful rare cancer, rare diseases and unmet need clinical trials and registries program.

It further provides better targeted support to improve Indigenous health and help Close the Gap; and better targets funding to improve outcomes for Aboriginal and Torres Strait Islander people, with funding for Indigenous Health of $3.9 billion from 2018-19 to 2021-22 and $10 billion over a decade. $33.4 million is provided for Aboriginal and Torres Strait Islander health workforce, and funding to prevent and treat complex and chronic health conditions including eye disease ($34.3 million), hearing loss ($30.0 million), and crusted scabies ($4.8 million).

The Government will invest in a stronger Rural Health Strategy to deliver high quality care. This will support having the right health care professionals in the regions through better teaching, training, recruitment and retention, including $95.4 million investment to create a number of schools and university programs.

Further healthcare investments include:

- Boosting essential infant and maternal health services
- Subsidising the cost of more insulin pumps for children with type 1 diabetes.
- Promoting a healthy and active Australia and extending the popular Sporting Schools Program

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