ESV
Business advice
and accounting

October 2022 Federal Budget White Paper

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Introduction

Treasurer Jim Chalmers handed down his first (and Labors first in 9 years) budget utilising “family friendly” and “responsible” tag lines, however, the budget is ineffectual in relation to some of the more fundamental problems faced by the Federal budget and households. Most households understand that you cannot spend more than you earn on an ongoing basis, however, the budget identifies this but fails to do anything about it, rather reference is made to more “conversations” being required.

In simple terms there is a structural problem with the Federal budget where the government expenditure exceeds revenue and therefore some hard “conversations” need to be had. Whilst rising interest costs put a dent in the budget, there are some of the flagship policies (eg the NDIS) which are putting increasing pressure on the budget with forecasted unsustainable spending increases.

Removing the political speak, “conversations” means spin and there is a clear trade-off between the promised expenditure to support the flagship policies and the Stage 3 tax cuts or other revenue raising. The Stage 3 tax cuts, which are designed to alleviate bracket creep would appear to be low hanging fruit in balancing the budget, however, how can this be positioned against a backdrop of pre-election promises and cost of living pressures on households? With electricity prices forecasted to increase by over 50% in the next two years a removal or restriction of Stage 3 cuts would appear to be directly opposed to easing the cost-of-living pressures.

From a taxation perspective, yet again the opportunity for structural reform was ignored given the inference that tax reform leads to tax increases, however, politically this was not palatable at this time. What the Treasurer was willing to do was to spend more money enabling the ATO to continue to undertake compliance activities. Whilst this has been labelled as a focus on multinationals, the reality is that the tax gap percentage is higher across high-net-worth individuals, small and medium businesses and individual sectors, than large corporate groups. Expect a closer look at these individuals and small and medium businesses.

Given the Federal electoral cycle with the next election due in 2025 (at the latest), it would be reasonable to expect that any pain to come in the form of increased taxes or reduced tax cuts will likely surface in the 2023 or 2024 budgets enabling the standard pre-election handouts in 2025.

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Personal Tax

Personal Tax Rates

There are no changes (as yet) to the individual income tax rates. They remain as follows:

Australian tax residents (excluding Medicare)

Rate (%)	Current thresholds Income range ($)	Thresholds from 1 July 2024 Income range ($)
Tax free	0 - 18,200	0 - 18,200
19	18,201 - 45,000	18,201 - 45,000
30	N/A	45,001 - 200,000
32.5	45,001 - 120,000	N/A
37	120,001 - 180,000	N/A
45	> 180,000	> 200,000

Non- residents

Rate (%)	Current thresholds from 1 July 2020 Income range ($)	Thresholds from 1 July 2024 Income range ($)
Tax free	N/A	N/A
19	N/A	N/A
30	N/A	0 - 200,000
32.5	0 - 120,000	N/A
37	120,001 - 180,000	N/A
45	> 180,000	> 200,000

Households and therefore taxpayers should, however, be acutely aware of the structural deficit and the impact this could have on the planned above tax cuts in the May 2023/24 budget or on other potential revenue raising measures (eg levies?).

Low and middle income tax offset (LMITO)

As previously flagged the LMITO is not available for the 2022-23 tax year and effectively is an increase in tax compared to prior year(s) which is counter intuitive to assisting households with the rising cost of living.

1

No change to personal tax rates (yet).

2

The lamington is gone :)

3

Cheaper childcare.

Paid Parental Leave ("PPL")

As part of the Governments cost of living measures, the pre-election promises have been honoured with an expansion to the scheme from 1 July 2023 enabling either parent to claim the payment.

From 1 July 2024, the PPL will be increased by 2 weeks per annum until it reaches a full 26 weeks from 1 July 2026 increasing the PPL period by 6 weeks.

Both parents will be able to use the entitlement and on a more flexible basis including blocks as small as a day at a time. A portion of the PPL will be available on a use it or lose it basis.

The income threshold for the household for the PPL will be increased to $350,000 allowing more households to qualify.

Child Care ("CC") measures

In a complementary policy to the PPL, the Government has announced an increase in availability of the CC measures. The changes increase the maximum CC subsidiary for the first child and increase the rate for all families earning less than $530,000 in household income.

The changes and increases are subject to a tapering for each $5,000 in income earned by families until family income hits $530,000. Whilst assistance to address CC costs is welcome, with the pressures on the budget, is providing cost subsidies to families earning more than $500,000 the best use of the funds? Noting the average annual wage is $70,000 meaning the average household would have $140,000 of income.

ATO Funding

An increase in funding for the ATO has been flagged, this not only focuses on multinationals and large businesses but also on individuals.

The key focus areas will be for individuals in relation to overclaiming of deductions and incorrect reporting of income. Taxpayers would be naïve to think that the ATO’s data systems and matching programs will not pick up variances with this being deployed through increased ATO reviews and enquiries given the tax gap.

In addition, the ATO will undertake a program focused on the shadow economy – think GST.

The ATO funding is forecasted to result in an increased recovery of tax which is more than five times the level of the increased recovery from multinationals under the other ATO programs. As such, it’s not really multinationals who are the focus – its households and Australian businesses, however, this is a politically savvy message.

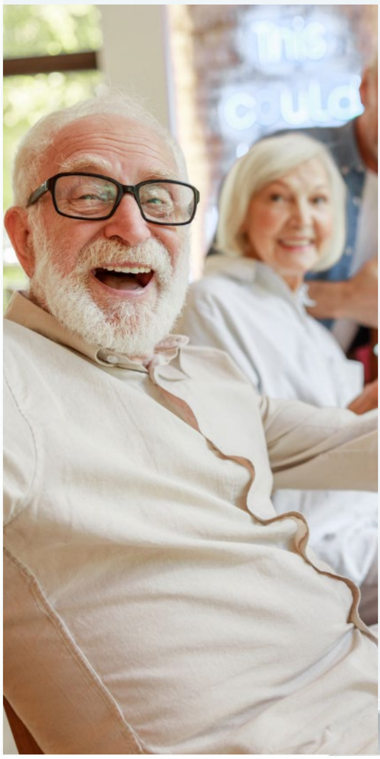
Superannuation

Superannuation rules remain relatively unchanged with some more administrative tinkering and previously flagged changes being confirmed.

The Government confirmed that the changes to the SMSF residency rules, previously announced in the 2021-22 Budget to commence from 1 July 2022, will now start from the income year commencing on or after the date of assent of the enabling legislation. This legislation is yet to be introduced.

Changes to the downsizer contribution program made as a pre-election promise will proceed, lowering the age to 55 (from age 60). This measure was introduced into House of Representatives on 3 August 2022 and will have effect from the start of the first quarter after assent.

This policy forms part of the Governments cost of living packages with a view to making housing more affordable by encouraging a rotation of housing stocks.



Business Tax

The Government continues to focus its attention on multinationals as part of reducing the tax gap and the overall stress on the budget. There were no substantial additional changes announced in addition to the pre-election promises.

Thin Capitalisation

As part of its positioning on multinationals and in line with the pre-election promise, a change to the thin capitalisation rules (the amount of debt deductions a company is allowed) has been announced with the intention that these will take effect from 1 July 2023.

The Government intends to replace the existing safe harbour and worldwide gearing tests with earnings-based tests to limit debt deductions in line with an entity's profits. The rules will be amended to:

- Replace the safe harbour test with a new earnings-based test capping debt-related deductions to 30% of profits (using EBITDA as the measure of profit). Deductions denied under this test will be able to be carried forward for up to 15 years and claimed in a subsequent year. This is presumably designed to deal with periods of low profitability or losses.
- Replace the worldwide gearing test with a test that allows an entity in a group to claim debt deductions up to the level of the worldwide group's net interest expense based on a share of earnings.

The arm's length debt test will be retained as a substitute test which will apply only to an entity's external (third party) debt - related party debt under this test would be disallowed.

SGE Deductions for Intangibles

In line with pre-election promises anti-avoidance rules will be introduced to prevent entities with a global group revenue of at least $1 billion from claiming tax deductions for certain payments made directly or indirectly to related parties. The payments (think royalties) in focus relate to intangibles held in low or no-tax jurisdictions.

For the purposes of the anti-avoidance rules a low or no-tax jurisdiction is a jurisdiction with:

- A tax rate of less than 15%; or
- A tax preferential patent box regime without sufficient economic substance.

1

Change to thin capitalisation rules.

2

Increased ATO funding for the better recovery of taxes.

3

Additional reporting requirements from 1 July 2023.

Intangible Assets

The proposed changes to allow taxpayers to self-assess the effective life of intangible depreciating assets has been scrapped. The changes originally flagged in the 2021-22 Budget were to apply to assets acquired from 1 July 2023.

As such, the effective lives of intangible depreciating assets will continue to be prescribed by law.

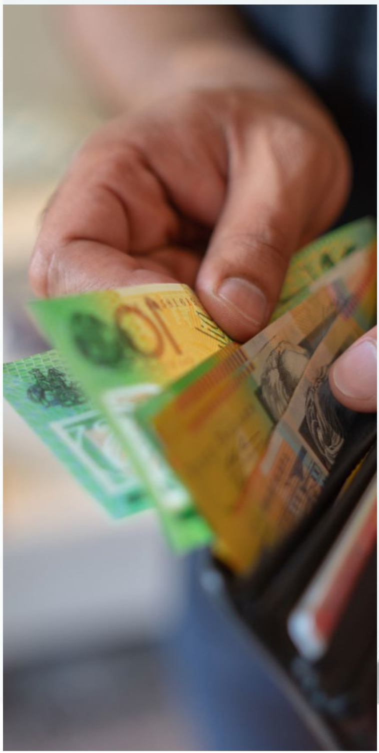
Other Technical Changes

- The Government intends to align the tax treatment of on and off-market share buy-backs undertaken by listed public companies. This will focus on the split of capital and dividend components with more details to follow on this.
- There are eight previously announced but unlegislated changes that will not proceed and three changes that have a deferred start date including:
  - Abandoned
    - debt equity definition changes;
    - asset back financing changes;
    - changes to limited partnership investment vehicles tax framework;
  - Deferred
    - certain Taxation of Financial Arrangements ("TOFA") changes proposed to apply from 1 July 2022 that will now apply to the income year on or after royal assent.

ATO Funding

Given the pressure on the budget it is no surprise that the Government has doubled down on increasing revenue through a better recovery of due taxes through an increase in funding for the ATO.

From a business perspective this will focus on already observed business tax risks which complement the ongoing focus on multinationals and, large public and private businesses.



Tax Transparency

As part of the focus on multinationals additional reporting requirements are set to be introduced to enhance the tax information made available to the public. The Government will require:

- Significant global entities to prepare for public release tax information on a country-by-country basis and a statement on their approach to taxation, for disclosure by the ATO;
- Australian public companies (listed and unlisted) to disclose information on the number of subsidiaries and their country of tax domicile; and
- Tenderers for Australian Government contracts worth more than $200,000 to disclose their country of tax domicile (by supplying their ultimate head entity's country of tax residence).

These new reporting requirements will apply for income years commencing from 1 July 2023.

ESV Services

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  - Tax mitigation and risk reviews
  - Strategic tax planning
  - Outsourced Tax Director
- Process improvement
- Fraud & risk management
- Director services
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- Doing business in Australia

Your Budget Expert

"Understanding tax consequences can have a significant impact on your business and cash flow."

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David leads ESV's Tax Consulting practice and is a market leader in providing taxation services to large and mid-sized businesses, family groups and high net wealth individuals. He has over 25 years' experience in the provision of taxation services including time at the 'Big 4' accounting firms in the UK and Australia and an 'in-house' stint at one of Australia's largest FMCG companies.

His specialist services includes; Corporate and Family Groups, Private Client Services, Tax Consolidations, Trusts, Structuring and Restructuring, International Tax including Thin Capitalisation, Due diligence for Mergers and Acquisitions and IPO, Tax Governance and Risk Management, Taxation of Financial Arrangements, Tax Controversy, Capital Gains Tax and Tax Training. David also acts for a number of clients in the role of 'Outsourced Tax Director' to provide specialist tax advice when a team needs it most.

David has extensive experience working with clients in a wide variety of industries including manufacturing and distribution, FMCG, IT and technology, professional services, energy, resources and property.

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