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TAX BRIEF

8 May 2018

Budget 2018-19

The Budget has become like Christmas – it is a season, not an event. This year's Budget Season began in mid-April with the regular and strategic placement of good news stories (and definitely no bad news stories): no increase to the Medicare levy, personal income tax cuts for low income earners, tax reductions for higher income earners but spread over a longer time frame, incentives for the film industry (and yet another attempt to tweak the R&D tax incentive), changing the excise system to benefit brewers of craft beer, a Taskforce to crack down on illegal tobacco sales, big spending on infrastructure (including more money for hospitals in WA), new drugs added to the Pharmaceutical Benefits Scheme, more spending on the aged, and so on. Budget Season will continue for a few weeks yet as the Government tries to impress upon us the messages it wants us to remember. This Tax Brief outlines the tax components of the Budget, both the good news and the bad.

1. Corporate tax

In April, the Treasurer revealed that tax receipts from July to December 2017 were $4.8bn higher than expected, and of that, almost $3bn was due to higher than expected company tax collections. Notwithstanding that surprise, the Government has announced a series of measures which will increase corporate tax revenue.

1.1 Digital economy

Towards the end of his speech the Treasurer alluded, ever so briefly, to his earlier statements to make sure companies in the digital economy pay 'their fair share of tax,' if necessary by unilateral action pending a multilateral resolution. He indicated that a Discussion Paper on options for taxing the digital economy will be released 'in a few weeks' time.'

This is likely to include the options that the EU announced in March 2018 of developing in the longer term rules to be incorporated in tax treaties for a 'virtual permanent establishment' in the countries of the users of digital platforms and attributing some of the platform owner's profits to those countries. In the interim, the EU proposed an interim digital tax of 3% on revenues of large companies involved in (i) selling online advertising space (such as Google and Facebook); (ii) digital intermediary services (which allow users to interact with other users to facilitate the sale of goods and services between them (such as Uber or Airbnb); or (iii) the sale of data generated from user-provided information (such as Palantir).

In March the OECD said its work on these issues would be completed in 2020 but more recently the OECD has shifted the date to 2019.

1.2 Valuation of assets for thin capitalisation purposes

The thin capitalisation rules will be amended to require entities to align the value of their assets for thin capitalisation purposes to the values used in their financial statements. There is currently some flexibility in the thin capitalisation rules to use asset values that are not contained in an entity's financial statements. In this regard, the ATO has been actively reviewing taxpayers who revalued their assets after the 2014 changes to the thin capitalisation rules (which reduced the safe harbour debt threshold to a 1.5 to 1 debt to equity ratio). The Government must consider that the robust review that comes with the preparation of financial statements affords additional integrity in this area. This measure will apply to income years commencing on or after 1 July 2019.

1.3 Classification of consolidated entities for thin capitalisation purposes

Foreign controlled Australian consolidated entities and multiple entry consolidated groups that control a foreign entity will now be treated as both outward and inward investment vehicles for thin capitalisation purposes. This will overcome a curiosity under the current thin capitalisation rules where these consolidated entities are deemed to be outward investment vehicles and different tests therefore apply. This change will apply for income years commencing on or after 1 July 2019.

1.4 'Significant global entity' definition

The definition of a 'significant global entity' ('**SGE**') will be broadened 'to ensure that Australia's multinational tax integrity rules operate as intended.'

SGEs are subject to the Diverted Profits Tax rules, the Multinational Anti-Avoidance Law and the Country by Country reporting obligations. While not mentioned in the Budget measures, any amendment to the SGE definition will presumably also have an impact on the increased penalty regime applicable to SGEs and the General Purpose Financial Statements lodgement obligations.

Under the current rules, an entity is regarded as a SGE for a particular income year if it satisfies one of the following:

- the entity is a 'global parent entity' ('**GPE**') with 'annual global income' of AUD$1bn or more; or
- the entity is a member of a group of entities consolidated for accounting purposes and the GPE of the consolidated group has annual global income of AUD$1bn or more.

The Government's proposal is to broaden the current definition 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 that may not otherwise be currently captured as they are not permitted to consolidate for accounting purposes.

For example, the new definition may have an impact on global funds including real property and private equity funds that currently may not be required to consolidate their Australian investments for accounting purposes.

The new measure will apply to income years commencing on or after 1 July 2018.

1.5 Tax consolidation

Budget Paper No 2 re-announced two changes already enacted by the *Treasury Laws Amendment (Income Tax Consolidation Integrity) Act 2018* which received Royal Assent in March this year. That is, the announcement reflects current law, not proposed changes. This is somewhat odd. The Budget will often recap announced but unenacted measures, but these measures have already been enacted.

The 'churning measure' ensures the consolidation tax cost setting rules will not apply to reset the tax cost of assets held by a non-land rich entity that joins a consolidated group or MEC group after being transferred from a non-resident entity who is not taxed on the transfer. This measure was clarified as requiring 50% common ownership within the previous 12 months based on an associate-inclusive test.

However, this clarification was amended so that it only took effect from introduction of the Bill on 15 February 2018. For the period from 14 May 2013, the test is not associate-inclusive.

The highly convoluted (and unworkable) transitional rule initially proposed for the removal of deferred tax liabilities ('**DTLs**') from an entity's exit tax cost setting calculation was removed. The enacted measure removed DTLs from both entry and exit amounts from the date of introduction of the Bill on 15 February 2018.

1.6 Denying deductions for costs of holding vacant land

The Government will deny deductions for expenses associated with holding vacant land, whether the land is for residential or commercial purposes. Deductions which have been denied will not be able to be carried forward for use in later income years but will be included in the CGT cost base of the asset.

The measure will not apply to expenses associated with holding land:

- that are incurred after any property constructed on the land is complete and available for rent; or
- where the land is being used by an owner to carry on a business.

The Budget Paper says somewhat cryptically, that '*the carrying on a business test will generally exclude land held for commercial development*.' It is not clear whether the Budget Paper is trying to say:

- '*the carrying on a business test will generally exclude* [from this measure] *land held for commercial development*' and sale; or
- '*the carrying on a business test will* [not extend to] *land held for commercial development*,' even if the land is being developed for sale.

On the other hand, it may be trying to say, if the land is being developed for retention and lease, then '*the carrying on a business test'* will not be met and so the measure would apply.

Further clarification will be required about the scope of the measure given its potential impact. The measure will take effect from 1 July 2019.

2. Managed investment trusts and AMITs

2.1 CGT discount

The Government proposes to prevent Managed Investment Trusts ('**MITs**') and Attribution MITs ('**AMITs**') from applying the 50% capital gains tax discount at the trust level. This measure will apply to payments made from 1 July 2019.

The measure is directed at Australian resident companies that are beneficiaries of MITs and AMITs. They can, at present, effectively access the CGT discount where deductions (such as interest) are offset against capital gains, even though companies are not meant to enjoy CGT discount. For example, if a trust has a gross, discountable capital gain of $1,000 and interest deductions of $500 it will have net income of nil:

Gross capital gain	1,000
CGT discount	(500)
Interest deductions	(500)
Net income	0

This means that an Australian resident corporate beneficiary would have no taxable income despite the fact that, if it had derived and incurred those amounts directly, it would have had taxable income of 500. Further, at least in the case of a MIT, the trust could distribute $500 as a CGT concession amount with no cost base adjustment for the corporate or non-resident beneficiary.

While the proposed measure may be considered an appropriate outcome for Australian resident corporate beneficiaries, this represents the classic 'sledgehammer to crack a nut' response. The proposed position will put all *other* Australian resident beneficiaries in a worse position than they would have been if they had made a direct investment. Using the example above, an Australian resident individual would have no taxable income if they made the relevant investment and borrowed themselves. However, if that person invests through a MIT, the position of the MIT will now be:

Gross capital gain	1,000
Interest deductions	(500)
Net income	500

The Australian resident individual will now include $500 in their assessable income. While that $500 may qualify for the CGT discount, some tax will be payable in circumstances where no tax would be payable if a direct investment would be made.

This negative outcome will also apply for complying superannuation funds. Again, using the example above a direct investment would produce the following result:

Gross capital gain	1,000
CGT discount	(333)
Interest deductions	(500)
Net income	167

Under the proposed change, the complying superannuation fund would have net income of $500, reduced to $333 after the CGT discount. In effect, the rate of taxation has been doubled on a complying superannuation fund in this example.

These examples show that the Government's statement that, '*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*,' is simply not correct for Australian resident beneficiaries.

In the case of non-resident beneficiaries of MITs and AMITs, the effect of the CGT discount is already reversed in calculating the amount of income to which MIT withholding tax applies. Thus, even under current law a non-resident beneficiary would be subject to withholding tax on its share of the gross $500 income in the example set out above.

Given that Australian resident corporations make up a tiny proportion of the overall investment in MITs and AMITs, it must be wondered whether Australian resident individuals and complying superannuation funds should have to pay an inappropriate amount of tax to address the perceived windfall for Australian resident corporations. It is not clear why the Government has avoided specifically targeting Australian resident corporations and instead used the blunt instrument of changing the calculation of net income at the trust level.

Aside from the substance of the proposed change, the application date of the measure is also problematic. The Government has stated that the 'measure will apply to payments made from 1 July 2019.' Just what this means is unclear since:

- beneficiaries of AMITs are subject to tax on an attribution basis, which is unrelated to whether there are any payments made by the AMIT; and
- beneficiaries of MITs are subject to tax on their share of the net income of the trust for the year as a whole, regardless of when distributions are made. It is not clear how the Government considers

that resident beneficiaries of MITs will be taxed for the year ending 30 June 2019 where some distributions are made before and some after 30 June 2019.

It is to be hoped that, at a minimum, the proposed measure will not apply to payments that relate to an income year that commences before 1 July 2019.

2.2 Expanded list of countries for reduced MIT withholding tax

A concessional rate of withholding tax (15%), currently applies to 'fund payment amounts' made to unitholders in a MIT that are resident in an 'information exchange country' listed in the regulations. There are currently 60 countries on this list but it has not been updated since 2012.

The Government announced that it will update the list of countries to include 56 additional jurisdictions that have entered into information sharing agreements since 2012. This updated list will be effective from 1 January 2019.

The announcement does not include the list of countries and it is not entirely clear what criterion the Government is using to identify the selected countries:

- if the requirement is that the other country *automatically* exchanges information with Australia, then it should extend to countries with which Australia has a comprehensive bilateral income tax treaty plus other countries which have signed the multilateral *Convention on Mutual Administrative Assistance in Tax Matters*, and in either case have signed the multilateral Competent Authority Agreement or a bilateral Competent Authority Agreement for Automatic Exchange of Information);

- if the requirement is the other country only exchanges information *on request* (which seems currently to be the case) then this would include any countries with which Australia has a comprehensive tax treaty or a Taxation Information Exchange Agreement, or that have signed the multilateral *Convention* but only exchange information on request.

Whatever the answer to that question, it is worth noting that Luxembourg will now be added to the list and Hong Kong remains a notable omission from the list.

2.3 Stapled structures

The Budget repeats the media release by the Treasurer on 27 March 2018 that the Government will introduce a package of measures to address the perceived integrity risks posed by 'stapled structures.' Broadly speaking, the following measures are being proposed:

- applying a 30% MIT withholding tax rate to distributions derived from trading income that has been converted to passive income (usually rent) using a MIT. Certain exemptions will apply for nationally significant infrastructure projects and for third party rents;

- thin capitalisation amendments to prevent double gearing structures. This will be achieved by lowering the associate entity threshold from 50% to 10%;

- limiting the foreign pension fund and sovereign immunity exemptions from withholding tax to portfolio investments only (that is, interests in the entity of less than 10%); and

- preventing agricultural MITs from accessing the 15% concessional MIT rate.

The thin capitalisation changes will apply from 1 July 2018. All other changes will apply from 1 July 2019 with a transitional period of at least seven years.

Our Tax Brief available **here** provides further details regarding these measures.

3. Small business measures

3.1 Extending the $20,000 instant asset write-off for small business

In the 2015-16 Budget the Government introduced a small business depreciation concession for assets costing less than $20,000. The measure was due to expire on 30 June 2017 but was extended in last year's Budget to expire on 30 June 2018. This year's Budget announces that it will be extended again to expire in 30 June 2019 at a cost to revenue of $550m. Small businesses with aggregated annual turnover of less than $10m can immediately deduct the cost of assets costing less than $20,000 which are first used or installed ready for use by 30 June 2019. From 1 July 2019, the immediate deductibility threshold will revert to $1,000.

Assets costing more than $20,000 can be put into a pool and depreciated at 15% in the year first included and 30% in subsequent years. If the pool balance falls below $20,000 before 30 June 2019, the balance can be immediately deducted. From 1 July 2019, the pool balance threshold will revert to $1,000.

The rules which prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out will continue to be suspended until 30 June 2019.

3.2 Amendments to Division 7A – unpaid trust entitlements

It has long been the view of the ATO that an amount to which a company that is a beneficiary of a trust is presently entitled, but which has not been paid to the company (an unpaid present entitlement or '**UPE**') should attract the application of Division 7A. The theory is that the amount represents a loan by a private company to the trustee of the trust (usually, an associate of a shareholder of the company) but a loan which is typically not appropriately documented and so not immune from challenge under Div 7A.

While the Commissioner had applied concessional treatment in some circumstances, from 1 July 2019, a new measure will 'clarify' that a UPE to a company beneficiary will be treated as a dividend under Div 7A unless a complying loan agreement has been entered into.

3.3 Delayed Div 7A amendments

In addition, the Government announced a deferred start date of 1 July 2019 for compliance-focused amendments to Div 7A that were announced in the 2016-17 Budget. Some of the main elements of the proposal include:

- a mechanism to amend without penalty arrangements which 'inadvertently' trigger the application of Div 7A;
- amended documentation requirements for Div 7A loans; and
- new safe harbour rules aimed at preventing the application of Div 7A in circumstances where an asset is provided for use by a company to a shareholder or associate.

A single package which combines all the Div 7A amendments will be enacted.

3.4 Removing small business CGT concession for partnership assignments

Partners who alienate their income by creating, assigning or otherwise dealing in rights to the future income of a partnership (including so-called *Everett* assignments) will no longer be able to access the small business capital gains tax concessions in relation to these transactions.

The Government has become convinced that some taxpayers, including large partnerships, are able to access these concessions inappropriately in relation to the assignment to an entity of a right to the future income of a partnership, without giving that entity any role in the partnership.

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In recent times the ATO has withdrawn its guidelines in relation to income splitting in professional firms (including *Everett* assignments) due to concerns regarding 'high risk' arrangements. The ATO is still formulating revised guidelines.

4. Personal income tax measures

4.1 Staggered reductions to personal income tax rates

The centrepiece of the Budget, so far as the Government is concerned, is the personal income tax cuts. While there is a modest tax cut scheduled to start on 1 July 2018, the most significant cuts are staggered over the period until 2024 – that is, after both the 2019 election and the election after that! The Treasurer promised that these measures would be legislated immediately (one can hear the faint echo of Paul Keating prior to the 1993 election declaring that his tax cuts were 'L-A-W'), but clearly these measures are subject to the vicissitudes of the election cycle.

The new rates and thresholds would be:

	Current rates 2017-18	**Stage 1 2018-19 to 2021-22**	**Stage 2 2022-23 to 2023-24**	**Stage 3 2024-25**
Tax-free amount	$18,200	$18,200	$18,200	$18,200
First rate, income between	19% $18,201 to $37,000	19% $18,201 to $37,000	19% $18,201 to $41,000	19% $18,201 to $41,000
Second rate, income between	32.5% $37,001 to $87,000	32.5% $37,001 to $90,000	32.5% $41,001 to $120,000	32.5% $41,001 to $200,000
Third rate, income between	37% $87,001 to $180,000	37% $90,001 to $180,000	37% $120,001 to $180,000	45% $200,001 and above
Fourth rate, income between	45% $180,001 and above	45% $180,001 and above	45% $180,001 and above	

These tax cuts come at a cost of over $13bn over the four year forward estimates.

Increased Medicare levy threshold. The Budget repeats the Government's decision to increase the various Medicare levy thresholds for the 2017-18 income year.

Extra ATO funding. The Budget also announces that the Government will give the ATO an extra $130m 'to increase compliance activities' focussed on individuals. The ATO is clearly concerned about the increasing cost of employee deductions and appears to have formed the view that tax agents are not an effective bulwark against incorrect claims. Part of the money will be devoted to continuing some of the ATO's income matching programs and other measures such as '*improving real time messaging to tax agents and individual taxpayers to deter over-claiming of entitlements …*'

The Budget estimates that for an outlay of $130m, the ATO will generate additional revenue of $1.1 billion.

4.2 Increase to the LITO

The Government's decision that the Budget would offer tax cuts to low income earners was leaked some time ago; over the weekend, it was revealed the mechanism for doing this would involve something similar to the Low Income Tax Offset ('**LITO**').

The Government has decided to supplement the LITO with another tax offset, the 'Low and Middle Income Tax Offset' ('**L&MITO**'), which will operate for four years, from 2018-19 to 2021-22.

LITO. The current LITO is valued at $445. It is payable in full until the taxpayer's taxable income reaches $37,000 at which point it is withdrawn at the rate of 1.5c for every extra dollar of taxable income and ceases entirely by $66,667.

From 1 July 2022, the government is proposing:

- taxpayers with taxable income up to $37,000: the LITO would increase to $645;
- taxpayers with taxable income between $37,001 and $41,000: the $645 tax offset is withdrawn at the rate of 6.5c for every extra dollar of taxable income;
- taxpayers with taxable income above $41,000: the tax offset is withdrawn at the slower rate of 1.5c for every extra dollar of taxable income and ceases entirely by $66,667.

L&MITO. This tax offset works in these stages:

- taxpayers with taxable income up to $37,000: they will receive an additional tax offset of $200;
- taxpayers with taxable income above $37,000 but less than $48,000: the $200 tax offset will *increase* at the rate of 3c per dollar of extra taxable income up to a maximum of $530. (Presumably this counters the *reduction* to the LITO occurring over part of this income range);
- taxpayers with taxable income between $48,001 and $90,000: these taxpayers will receive the maximum tax offset of $530;
- taxpayers with taxable income above $90,000: the $530 tax offset is withdrawn at the rate of 1.5c for every extra dollar of taxable income and ceases entirely by $125,333.

From the Government's point of view, there would seem to be several benefits from delivering the tax cut in this way: unlike an increase to the tax-free threshold or a reduction in the bottom rates, the benefit is delivered only to people whose taxable income is low, it does not affect PAYG collections, it can only be accessed by people who go to the trouble of filing an income tax return, and there is a lot of wastage (the LITO is not refundable, can't be transferred and can't be carried forward, and one assumes the L&MITO will follow the same pattern).

On the other hand, a tax cut delivered by the LITO and L&MITO is all but invisible to most voters. No-one will see the impact of this tax cut in their pay slip once it begins.

4.3 Increase to Medicare levy cancelled

The biggest single revenue-raising measure in the 2017-18 Budget was the announcement of an increase to the rate of the Medicare levy from 2% to 2.5% from 1 July 2019, a measure which was expected to raise more than $8bn over the forward estimates. And in a break from Treasury tradition, this revenue was actually to be ear-marked to fund the National Disability Insurance Scheme with the Government promising to credit the funds 'to the NDIS Savings Fund Special Account when it is established.'

The Labor party supported the increase to the Medicare levy rate but only for individuals with taxable income above $87,000. The Government was unwilling to compromise and so the package of 11 Bills has been stalled in the Senate for the last 6 months.

It was not surprising when the Treasurer announced in late April that this measure would be scrapped. Not only was the proposal unachievable in the current political climate, it would undermine the Government's preferred message – people should focus on the personal income tax cuts being offered in the Budget, not the tax increase planned for 2019.

5. Superannuation

The Budget announces that the Government will:

- ban exit fees, cap fees for low balance accounts under $6,000, require low balance inactive accounts to be transferred to the ATO and make insurance optional for low balance accounts, inactive accounts and accounts for members aged under 25 years (members will have to 'opt-in' to any insurance component);
- allow new retirees aged 65 to 74 with less than $300,000 in superannuation to make voluntary contributions in the year after they fail the 40 hours in 30 days 'work test';
- require superannuation funds to formulate and offer a comprehensive income in retirement product for members and provide favourable Age Pension means testing for pooled lifetime income stream products;
- allow high paid employees with more than one job that causes mandated contributions to exceed the $25,000 concessional contributions cap to partly opt out of superannuation guarantee;
- adopt compliance procedures to reduce the incidence of employees claiming tax deductions for personal contributions where they have not advised the fund by submitting a valid and acknowledged 'notice of deduction' form (so that the fund is unaware that it has to pay 15% tax on the contribution); and
- increase supervisory levies to pay for increased ATO compliance.

6. Indirect taxes

6.1 Online hotel accommodation providers

Offshore sellers of hotel accommodation such as Wotif, Expedia and Bookings.com that provide Australian hotel accommodation will be required to calculate their GST turnover in the same way as local accommodation providers from 1 July 2019.

As a result, online providers that make sales of hotel accommodation in Australia of over $75,000 per annum will be required to register for GST and charge GST on the sales, capturing GST on their mark-up on the accommodation. The additional GST should only be on the margin as they will also be entitled to claim input tax credits on GST incurred on their acquisitions.

This measure comes after extensive ATO audit activity in the sector which recognised the 'uneven playing field' and also aligns with the move to tax digital supplies from offshore.

The Government estimates that this will raise $15m over the forward estimates period. It will only apply to sales made after 1 July 2019 and so should exclude a hotel stay after 1 July 2019 that was paid for prior to that date. Initially this cost falls on the offshore sellers but will likely be passed on to consumers or back to hotel operators.

6.2 Other online accommodation providers

In addition, the Government has noted a recommendation in the *Black Economy Taskforce Final Report* which suggested it examine how GST should apply to accommodation provided through Airbnb

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and similar platforms. The Government response was merely to note that such providers may need to account for GST on those sales where they reach the turnover of $75,000 per annum.

6.3 GST and ABN aspects of phoenix activity

The Government has announced measures directed to combating illegal phoenix activity including extending the Director Penalty Regime to GST, luxury car tax and wine equalisation tax. This measure will make directors personally liable for the company's debts for these taxes.

The Director Penalty Regime currently makes directors personally responsible for PAYG and superannuation guarantee charge, which only has an impact on companies with employees. Extending this regime to GST will affect thousands more companies, and thus many thousand more directors than the current regime. The Australian Institute of Company Directors raised multiple concerns in its response to the Treasury Consultation, noting 'to impose personal liability for corporate breaches occurring at a time when the new director had no actual or legal ability to influence the conduct of the corporation offends a fundamental tenet of the rule of law.'

No details of how these measures will apply has yet been provided but presumably all company directors will now take a keener interest in the GST compliance of all entities for which they have a fiduciary responsibility. This regime will put pressure on in-house tax teams to reassure the Boards of every company in the group that GST has been correctly paid.

The Government also indicates its intention to overhaul the ABN system (including possible renewal of ABNs), a review of the business register and verifying ABNs in electronic payment processing.

7. Tax administration – the Black Economy

The final report of the *Black Economy Taskforce* and the Government's response to 'tackle the black economy' were released together with the Budget papers. The *Black Economy Package* in the Budget contains a number of announcements, mainly directed at tax administration and compliance to assist in revenue recovery, and which follow on from the *Tax Integrity Package* in last year's Budget. The *Black Economy Package* includes the following measures.

7.1 Taxable payments reporting system

The taxable payments reporting system ('**TPRS**') is a transparency measure that requires businesses to report to the ATO all payments they make to certain contractors. From 1 July 2019, the TPRS will be further extended to cover the following industries:

- security providers and investigation services;
- road freight transport; and
- computer system design and related services.

7.2 Cash payment limit

In order to tackle tax evasion and money laundering, a limit of $10,000 for cash payments made to businesses for supplies of goods and services will be introduced from 1 July 2019. An electronic payment method or cheque will be required instead.

Carve outs from this measure are anticipated for consumer to consumer (non-business) transactions, and for transactions with financial institutions (which would still be subject to existing anti-money laundering and counter-terrorism financing reporting requirements).

7.3 Removal of tax deductibility for non-compliant payments

A business that has not withheld PAYG from a payment of employee remuneration, or to a contractor that has not quoted an ABN when required, will not be entitled to claim an income tax deduction for the payment. This measure will apply from 1 July 2019.

This appears intended as a financial deterrent in addition to the existing regime, that already imposes an administrative penalty for failure to withhold when required under the PAYG system. However, as acknowledged by the *Black Economy Taskforce Report*, it requires the non-withholding to be detected, and also for phoenix type activity to be thwarted in order to recover tax shortfalls.

7.4 Government enforcement

Additional funding of approximately $300m over four years will be provided to the ATO 'to implement new strategies to combat the black economy' and 'to support the new multi-agency Black Economy Standing Taskforce', in order to ensure a more coordinated approach to combatting the black economy. This will include increased ATO audit activity, use of improved data analytics and information sharing between Government agencies.

A significant return is forecast to be delivered from this new funding (a gain to revenue of $3bn, and to cash receipts of $2.5bn, over the four year forward estimate period).

7.5 Further action to combat phoenix companies

In December 2015, the Productivity Commission released the *Final Report* from its inquiry into *Business Set-up, Transfer and Closure*.

The first measure announced following the *Report* was the proposed introduction of Director Identification Numbers. This was the subject of a Press Release from the Minister for Revenue and Financial Services on 12 September 2017. In that Press Release, the Minister also referred to 11 other measures to 'deter and disrupt the core behaviours of phoenix operators, including non-directors such as facilitators and advisors' upon which consultation would be sought.

The Budget announcement seeks to implement 6 of those measures (albeit with tweaks). Measures specifically referred to in the Budget Papers are:

1. the introduction of new phoenix offences to target those who conduct or facilitate illegal phoenix activity;
2. prohibiting entities related to the phoenix operator from appointing a liquidator – the Budget announcement differs in that related creditors will be restricted in their ability to vote on the appointment, removal or replacement of an external administrator;
3. preventing directors from backdating their resignations to avoid liability or prosecution;
4. limiting the ability of directors from resigning and leaving a company with no directors; and
5. expanding the ATO's power to retain tax refunds where there are outstanding tax lodgements.

There is still some unfinished business from the 12 September 2017 Press Release and we wait to learn the fate of the remaining measures:

1. the establishment of a dedicated phoenix hotline – the Government refers to a 'new hotline' to report illegal activity in the black economy in its response to the *Black Economy Taskforce Final Report* (both the *Report* and the response were released along with the Budget papers);
2. the extension of the promoter penalty regime to capture advisers who assist phoenix operators – the Government agreed with this measure in principle, and refers to implementing 'a comprehensive package of reforms which focus on deterring, disrupting and penalising those who

engage in illegal phoenixing activity.' This is likely to be part of the new phoenix offences to be introduced as noted above;

3 stronger powers for the ATO to recover security deposits from suspected phoenix operators – perhaps the GST withholding regime on property developers is seen as a 'toe in the water' for this measure;

4 a 'next-cab-off-the-rank' system for appointing liquidators; and

5 allowing the ATO to commence immediate recovery action following the issuance of a Director Penalty Notice.

8. Other measures

TOFA. The Budget confirms the Government's decision, announced in December last year, to defer the start date of measure arising from the project to reform various aspects of the TOFA regime. The project will apparently try to improve the design and functioning of the basic accruals and realisation system, the forex regime in TOFA and the hedging regime in TOFA.

R&D. The Government is trying yet another design for the R&D tax incentive 'to better target the program and improve its integrity and fiscal affordability.' The proposed changes will implement recommendations made in the 2016 *Review of the R&D Tax Incentive*. The changes will apply for income years starting on or after 1 July 2018.

Treatment of concessional loans in entities that become taxable. When a tax exempt entity becomes a taxable entity (eg, a privatisation occurs), the rules in Division 57 operate to deem liabilities held by the entity to have been assumed for a payment equal to the 'adjusted market value' of the corresponding asset in the hands of the person to whom the liability was owed. In the case of a concessional loan, this would likely lead to a market value below the face value of the loan. When the loan is repaid, Division 230 treats the difference between the face value repaid and the market value at the time the entity became taxable as a loss and therefore the entity obtains a deduction for a portion of the principal.

For entities that become taxable after 8 May 2018, a tax deduction will not be allowed for that principal amount by requiring the liability to be valued as if it were on commercial terms.

Revolving trust distributions. The Budget announces that the Government will apply 'a specific anti-avoidance rule that applies to … closely held trusts that engage in circular trust distributions' to family trusts. Just which particular provision the drafters have in mind is not spelt out but the most likely candidate is Div 6D ITAA 1936 – a regime which requires the disclosure of the ultimate beneficiaries of a trust which has as one of its beneficiaries the trustee of another trust. The measure does not start until 1 July 2019 so there is clearly no great urgency to the measure.

Income of minors from testamentary trusts. The Government has announced it will change the taxation of the unearned income of minors received from testamentary trusts. Income from testamentary trusts is currently subject to tax at ordinary rates; that is, the income is not subject to the punitive rates that apply to other types of unearned income of minors. From 1 July 2019, marginal rates will only apply to 'income … from assets that are transferred from the deceased estate or the proceeds of the disposal or investment of those assets …'

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