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2023 FEDERAL BUDGET REPORT

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INTRODUCTION

In a climate characterised by acute cost of living pressures, Treasurer Chalmers' second budget has put the spotlight on easing the impacts of rising inflation and driving wage growth.

It's clear the Government is committed to achieving responsible and targeted relief for the Australian community at large, by building a stronger and more sustainable care economy.

A range of measures were announced to provide timely benefits for individuals. From financial relief to cope with the cost of electricity, to higher welfare payments for parents, jobseekers, students and those seeking rental assistance, increases in wages for aged care workers and a record tripling of the Medicare bulk-billing system.

For businesses – large and small, domestic and multi-national - it's time to expect many more visits from the ATO, as the emphasis is clearly on a compliance push. The benefits to small businesses are relatively immaterial or outweighed by an additional administrative burden, particularly the changes to the instant asset write off scheme and superannuation payment frequency adjustments. For large corporates, certainty has been provided around the 1 January 2024 start date for a 15% minimum tax rate and proposed amendments to the general anti-avoidance rules in Part IVA will pack more of a punch.

Ultimately, what is most evident is that the creation of a sustainable revenue system is still not part of the plan. From our perspective, building a sustainable economy relies on a sustainable revenue system and, at the moment, there is much room for improvement. How can Australia ensure the long-term viability of its tax system without a proactive effort now?

BUSINESS RELIEF

INCREASING AUSTRALIA'S HOUSING SUPPLIES

The Government is introducing multiple measures to stimulate an increase in Australia's housing supply by targeting new build-to-rent (BTR) projects and increasing access to affordable housing schemes.

BUILD-TO-RENT PROJECTS

The following incentives for BTR projects are proposed:

- Increasing the capital works depreciation rate from 2.5% to 4% for eligible new BTR projects where construction commences after 9 May 2023
- Reducing the withholding tax rate from 30% to 15% for eligible fund payments made from 1 July 2024 by management investment trusts (MITs) to foreign residents on income from newly constructed residential build-to-rent (BTR) properties.

These concessional measures are proposed to apply to BTR projects that:

- Consist of 50 or more apartments or dwellings made available for rent to the general public
- Are held under single ownership for at least ten years before being sold
- Offer a lease term of at least three years for each dwelling.

The Government is also seeking further consultation on the proposed eligibility criteria, including whether a minimum proportion of dwellings need to be offered as affordable tenancies.

Capital works

Currently, the capital allowance rules for buildings and other capital works allow for a depreciation rate of 2.5% (or a 40 year effective life) for residential buildings constructed after 26 February 1992 and used for the purpose of producing assessable income.

The proposed changes will increase the depreciation rate for new BTR properties to 4% and will mean the amount of depreciation claimable as a tax deduction is brought forward.

MIT withholding

Under the MIT regime, the trustee of a withholding MIT that makes a fund payment to a foreign resident is required to withhold an amount from the payment at the applicable rate. The MIT withholding rate is 30% unless reduced to 15% for fund payments made to a tax resident of listed information exchange countries. However, for fund payments made on or after 1 July 2019, the MIT withholding rate has been increased to 30% for payments attributable to non-concessional MIT income (NCMI).

NCMI includes MIT residential housing income, which is assessable income derived by a MIT to the extent that it is attributable to a residential dwelling asset (whether or not held by the MIT) that is not otherwise considered commercial residential premises.

The proposed changes will reverse the previous increase in the MIT withholding rate for residential housing income and allow foreign investors from more than 130 countries to access concessional tax rates of 15% when investing in Australian BTR projects.

AFFORDABLE HOUSING

The Government is introducing the following measures to support social and affordable housing and increase access for home buyers:

- Increasing the government-guaranteed liability cap of the National Housing and Finance Investment Corporation (NHFIC) to enable the NHFIC to increase its support for social and affordable housing through loans from the Affordable Housing Bond Aggregator
- Requiring the NHFIC to allocate a minimum of 1,200 homes to be delivered to each state and territory within five years of the Housing Australia Future Fund commencing operation
- Expanding the eligibility of the Home Guarantee Scheme to allow individuals who are not spouses or de-facto partners to access the scheme. These individuals include any two eligible people as joint applicants, non-first home buyers who have not owned a property in Australia for at least ten years to access the guarantee, single legal guardian of children, and Australian permanent residents
- Redirecting interest earnings on unallocated NHFIC funds to support social and affordable housing.

BDO COMMENT

These measures aim to make the MIT regime and investment into Australia more attractive to international investors. This is positive in the midst of Australia's housing crisis - with the lack of supply further exacerbated by cost of living pressures and the collapse of numerous construction companies.

When the previous increase in MIT withholding rates for NCMI was announced in 2019, it generated significant media coverage by the global REIT industry, with headlines that stated Australia was no longer a tax effective jurisdiction for BTR investments. As such, the proposed reduction in MIT withholding rates for residential housing income is a welcome change to ensure Australia can continue to attract much needed foreign capital for BTR construction projects.

The proposed increase regime has not been reintroduced. Without this, the attractiveness of commercialising intellectual property in Australia is lessened and it is likely the associated flow-on benefits, such as further investment and development activities, will instead be reaped by other jurisdictions that provide more generous incentives.

Whilst these measures and the proposed changes to the Government's various housing schemes are a positive step towards solving Australia's residential housing crisis, we suggest the Government needs to carefully consider the consultation submissions received to ensure the eligibility conditions imposed are not so onerous that they counteract the intended tax benefits of these measures.

MANAGED INVESTMENT TRUSTS: FOREIGN INVESTMENT TO SUPPORT AUSTRALIAN DECARBONISATION

The Government has proposed expanding the concessional withholding tax rate for certain Managed Investment Trusts (MITs) that distribute to foreign resident investors. Currently, certain MITs that hold a "clean building" with an energy rating of five or above, apply a withholding rate of 10% rather than the standard 15% when they make distributions to foreign investors.

"CLEAN BUILDINGS": WHAT'S IN A NAME?

The centre piece of the Government's amendments is to add an asset class to the term "clean buildings." For buildings where construction commences after 9 May 2023, the term "clean building" will apply to warehouses and data centres as well as hotels, shopping centres and office buildings. The lower tax rates will apply from 1 July 2025.

However, the energy rating required to satisfy the clean requirement will be increased to a six-star energy rating for all building types, potentially shutting out buildings that previously qualified under the old definition. There is to be a transition period, and this will be the subject of further consultation.

The Government hopes to incentivise foreign direct investment in green energy by reducing the tax burden associated with these investments. Simultaneously, it will increase the benchmark necessary to qualify for the incentives.

BDO COMMENT

The extension of clean buildings to include data centres and warehouses is potentially significant because these buildings are very energy intensive. Further, requiring existing buildings to improve their energy rating is commendable, despite the understandable negativity about the transition period for entities that have already broken ground on their five-star rated buildings.

It is also of note that the tax benefits of investing in clean buildings is provided predominantly to non-residents under these measures. BDO questions why domestic taxpayers do not also receive a similar incentive.

SMALL BUSINESS SUPPORT MEASURES

The Government has announced multiple support measures aimed to increase investment and decrease administrative burden for Australian small businesses, with a particular focus on improving cashflow and improving business efficiency.

PAY-AS-YOU-GO INSTALMENT CHANGES

The Government has announced an amendment to set the GDP adjustment factor for pay-as-you-go (PAYG) and GST instalments at 6% for the 2023-24 income year, a reduction from 12% under the current statutory formula. The change to the GDP adjustment rate will apply to small businesses and individuals who are eligible to use the relevant instalment methods up to $10 million aggregated annual turnover for GST instalments and $50 million aggregated annual turnover for PAYG instalments. This discount in the GDP adjustment rate reflects wider economic conditions – particularly the high inflation rate and tightened small business cash flows.

TEMPORARY INCREASE OF THE INSTANT ASSET WRITE-OFF

The current temporary full expensing incentives are set to expire on 30 June 2023, reverting the Instant Asset Write-off threshold back to the legislative threshold of $1,000. The Government has subsequently announced a temporary increase of the Instant Asset Write-off threshold for another year.

Small businesses with an aggregated annual turnover of less than $10 million will be able to immediately deduct the full cost of eligible assets costing less than $20,000 that are first used or installed ready for use between 1 July 2023 and 30 June 2024.

SMALL BUSINESS ENERGY INCENTIVE

As announced at the end of April, the Government aims to introduce the Small Business Energy Incentive program to encourage small and medium-sized businesses to reduce energy costs and lower emissions. Under this program, businesses with an annual turnover less than $50 million will be able to access an additional 20% deduction on spending that supports electrification and more efficient use of energy.

Total expenditure up to $100,000 will be eligible for this incentive, with the maximum additional tax deduction being $20,000 per business. Eligible assets or upgrades must be first used or installed ready for use between 1 July 2023 and 30 June 2024.

REDUCTION IN SMALL BUSINESS ADMINISTRATIVE BURDEN

The Government has provided funding to the ATO to lower tax related administrative burdens for small businesses including:

- An 18-month trial extension from 1 July 2024 expanding the ATO independent review process to small businesses with an aggregated turnover between $10 million and $50 million subject to an ATO audit
- Improved access for small businesses to tax advice and assistance from 1 January 2025 through establishing five tax clinics. Funding eligibility will be extended to TAFE institutions to improve access in regional areas.

Further, the measure also delivers reforms to reduce administrative requirements and time managing taxes including:

- From 1 July 2024:
  - Small businesses will be permitted to authorise multiple single touch payroll forms for lodgement on their behalf
  - The ATO will reduce its use of cheques to provide faster, safer and cheaper income tax refunds
- From 1 July 2025:
  - Permitting small businesses to apply the standard four-year amendment period for income tax returns, reducing the burden of making revisions.

BDO COMMENT

Whilst the additional support to Australian small businesses is welcome, BDO is concerned the incentives do not go far enough. Many of the incentives outlined by the Government are temporary in nature, which may lead to uncertainty for small business owners, the backbone of Australia's economy.

Further, the significant reduction in the instant asset write-off threshold from 1 July 2023 means that businesses wanting to take advantage of the current generous incentives will need to rapidly acquire assets before 30 June this year.

NATIONAL RECONSTRUCTION FUND CORPORATION AND OTHER INCENTIVES

NATIONAL RECONSTRUCTION FUND CORPORATION ESTABLISHMENT

The Government has committed $61.4 million over four years (commencing 2023-24) to establish the National Reconstruction Fund Corporation (NRFC). This builds on and is partially offset through the redirection of funding allocated in the October 2022 budget, where the Government announced the establishment of the National Reconstruction Fund (NRF). At the time of the October 2022 announcement, $15 billion was to be allocated to partner with the private sector, to support investment capable of growing the economy and increasing employment.

The $61.4 million allocated to establishing the NRFC will include:

- $53.2 million in 2023-24 for establishment and operational costs
- $8.2 million over four years from 2023-24 (and $1.2 million each year ongoing) for the Department of Industry, Science and Resources to support the establishment and provide oversight of the NRFC.

Funding under the NRF is still slated to be delivered in the form of finance options including loans, equity investment and guarantees, with estimated receipts of $188.7 million anticipated to be earned from the $15 billion to be provided to recipients of the NRF.

No further information has been provided in respect to the key sectors set to benefit from the NRF, however, based on commentary provided by the Department of Industry, Sciences and Resources, we understand these to remain unchanged, being:

- Renewables and low emissions technologies
- Medical science
- Transport
- Value-add in agriculture, forestry and fisheries sectors
- Value add in the resources sector
- Defence
- Enabling capabilities.

OTHER INCENTIVES

The Government has announced $80.5 million of support over four years to assist the critical minerals sector. Of this, $57.1 million has been allocated to promote critical minerals projects and assist in building supply chains. A further $23.4 million will be provided for policy development and project facilitation. However, no funding has been allocated to the Critical Minerals Development program, suggesting no future rounds of funding will be provided for this program.

The establishment of the $2 billion Hydrogen Headstart program, which is slated to provide revenue support for renewable hydrogen investment, will seek to accelerate the development of hydrogen capabilities.

Support for the Australian space industry will be further refocused, with a reduction in funding of approximately $35 million over the forward estimates.

Finally, the Government will repurpose and expand funding previously available to small and medium businesses through the $400 million Entrepreneurs Programme, with $392.4 million over four years from 2023-24 allocated to establish the Industry Growth Program (targeting businesses operating in the priority areas of the NRF).

BDO COMMENT

As we noted in response to the October 2022 Budget, the delivery of NRF funds via loans, guarantees and equity is a marked difference to the previous government's strategy, which involved delivering generous grant funding to successful applicants who were able to show they had met increased employment and other project objectives. These announcements establish a fund but give no current indication as to how or when such funding will be provided to Australian companies.

The budgetary measures announced provide a stark contrast to Ed Husic's recent calls for raising Australia's R&D spending to "towards 3% of GDP" by 2030, with nothing in the Budget able to support such an increase in spending. The NRF could have contributed to this increase had the $5 billion in funding allocated for initial spending been distributed. However, according to Ai Group only $550 million in seed funding is anticipated to be received by the NRF this year (being 3.6% of total allocated funding). This increase in R&D spending could also have been supported by further direct investment in strategic industries not directly covered by the NRF, such as space.

Additionally, while there has been noise around supporting Australia's critical minerals industries, the support provided in the Budget appears to be lacking in proper substance, which is a concerningly consistent and disappointing theme from a science and research perspective.

Our disappointment is compounded by the confirmation that the patent box regimes previously announced have been scrapped. This would have been a welcome measure to encourage the international commercialisation of Australian-developed technology to be retained in Australia. The scrapping of these measures is short sighted and in contrast to the rhetoric on supporting innovation and commercialisation in Australia.

REDUCING COMPLIANCE COSTS FOR GENERAL INSURERS

The Government will introduce legislation to amend the tax law to align the taxation of insurance companies with the new accounting standard, ***AASB 17 Insurance Contracts*** (AASB 17).

Before the introduction of AASB 17, there were specific accounting standards for life and general insurance contracts, which were:

- AASB 4 which applies to insurance contracts
- AASB 1023 which applies to general and health insurance companies
- AASB 1038 which applies to life insurance contracts.

AASB 17 replaces all accounting standards that deal with insurance contracts.

The taxation of insurance companies currently mirrors the accounting treatment in AASB 1023 and AASB 1038. However, the introduction of AASB 17 meant that the tax law is no longer aligned with the accounting standards.

An amendment to the tax law will allow general insurers to continue using audited financial reporting information, which is calculated according to the new standard, as the basis for their tax returns.

The new measure will have effect for income years commencing on or after 1 January 2023.

BDO COMMENT

The misalignment between the tax law and the new accounting standard for general insurers has caused some anxiety and concern within the insurance industry since 2019 when IFRS 17 (the international standard equivalent to AASB17) was endorsed. Since then, the Insurance Council of Australia, Financial Services Council and affected insurers have been discussing the misalignment issue with the Australian Accounting Standards Board and the ATO to lobby Treasury for a resolution. As such, the Government's proposal is a welcome relief for the general insurance industry.

No specific details of the legislation have been released, so insurance industry organisations will need to wait longer to determine if all their concerns are alleviated.

BUSINESS CRACKDOWNS

TAX LIABILITY LODGEMENT TASKFORCE AND AMNESTY PROGRAM

The ATO will receive additional funding over a four-year period from 1 July 2023 to assist with effectively engaging businesses to address outstanding tax and superannuation liabilities.

The additional funding will allow the ATO to target taxpayers who have high-value debts greater than $100,000 and aged debts older than two years where those taxpayers are either public and multinational groups with an aggregated turnover of greater than $10 million, or privately owned groups or individuals controlling more than $5 million of net wealth.

Alongside the additional funding, the Government has announced a lodgement penalty amnesty program that will allow small businesses with an aggregate turnover of less than $10 million to re-engage with the ATO regarding their overdue lodgements. Under this program, the ATO will remit failure-to-lodge penalties associated with outstanding tax statements lodged in the period from 1 June 2023 to 31 December 2023 that were originally due during the period from 1 December 2019 to 29 February 2022.

Under these measures the ATO is expecting to increase payments by $275.4 million over five years from 2022-23.

BDO COMMENT

Disappointedly the amnesty approach appears narrowly targeted, however BDO agrees with the importance of improving compliance with tax lodgement obligations. We support the amnesty program aimed at encouraging small businesses with outstanding lodgements, as the payment of outstanding superannuation liabilities directly benefits Australian employees. There is an open question why the amnesty only applies to lodgements that should have been made up to 29 February 2022, rather than the current time.

Further to the announced measures, BDO would have liked to have seen additional funds directed to the ATO to help improve efficiencies associated with processing returns and refunds for those taxpayers that are compliant with lodgement deadlines.

SUPER TO BE PAID ON PAYDAY

The Government announced it will require superannuation guarantee contributions to be paid by employers at the same time as their employees' salary and wages.

This measure was previously announced by the Treasurer on 2 May 2023 and is proposed to commence on 1 July 2026.

Employers must currently pay super guarantee contributions on a quarterly basis by the 28th day after quarter end. The current payment due dates are 28 April (for the March quarter), 28 July (for the June quarter), 28 October (for the September quarter) and 28 January (for the December quarter).

The Treasurer stated that by switching to payday super, a 25-year-old median income earner currently receiving their super quarterly and wages fortnightly could be around $6,000 or 1.5% better off at retirement. This is on the basis that more frequent payments would lead to higher earnings on investments, since the contribution is available to be invested each payday, compared to each quarter.

The proposed measure will mean employers must align their super guarantee contributions payments with their payday. Depending on the employer's payroll frequency, this could mean 52 times (for weekly payrolls), 26 times (for fortnightly payrolls), or 12 times (for monthly payrolls). When compared to the current requirement of four payments per year (based on quarters), this is a large increase in super payment frequency, regardless of which payroll frequency an employer uses.

The proposed measure also acknowledges that changes to the design of the superannuation guarantee charge will be necessary to align with increased payment frequency. The Government will consult on the design of these changes, with the final design to be considered as part of the 2024-25 Budget.

The Australian Taxation Office (ATO) will receive additional resourcing to help it detect unpaid super payments earlier, including through improvement to data matching capabilities. The Government will set enhanced targets for the ATO for the recovery of payments. The ATO and Treasury will consult closely with industry and stakeholders on these changes in the second half of this year.

BDO COMMENT

This proposed measure will result in significant additional compliance costs for employers, as they will need to meet single touch payroll deadlines to pay super. This will create additional non-compliance risk and possibly the superannuation guarantee charge (SGC), which includes interest plus an administration fee on top of the late paid super. Significant penalties can also apply, including 200% of the applicable SGC.

Another area to consider is the administration cost of preparing the SGC statements for non-compliance. This announcement would suggest that SGC statements would be required for non-compliance for each relevant pay period. This could result in a significant amount of administration to collate the details of each employee's payments and personal details for each SGC statement. For example, if there was a non-compliance issue for three months and the pay period was fortnightly, there would be six SGC statements required under the announcement, rather than one SGC statement under the current law.

Under the current system, the SGC is non-deductible for income tax purposes. It would be quite onerous to identify the non-deductible amounts, under the announced proposed system, because of the additional payment frequency.

The SGC currently includes an administration component of $20 per employee per quarter. This $20 administration component per SGC statement could add up to a significant cost for employers who are required to undertake more frequent SGC statements under the proposed measure.

Further, under the current system the super contribution is only considered compliant when the payment reaches the employee's super account within the required timeframe. Under the proposed measure this would mean that where superannuation fund clearing houses are used, they would need to shorten the timeframes for processing, to meet the shorter payment timeframes requirements.

Employers will need to ensure they immediately link new employees to the employer in the Single Touch Payroll system under these proposed measures. Where employees do not provide details of their super fund, the employer will also need to immediately request details of the stapled fund from the ATO. Further, the ATO will need to shorten the timeframes for providing the details of stapled funds to ensure employers can make payments in time.

In short, the proposed measure will result in significant additional compliance costs and an extensive administrative burden on employers. We believe that as currently designed, these costs to business far outweigh the benefits to employees of higher earnings in their super funds. The announcement has stated that changes to the design of the SGC will be made, which may address some of the administrative burdens we have outlined above. We strongly urge the Government to consult with industry early and intensively to ensure this promise is delivered.

OECD BEPS 2.0: PILLAR TWO - GLOBAL MINIMUM TAX/DOMESTIC MINIMUM TAX

The Government has announced the adoption of rules aligned with Pillar Two of the international corporate tax reforms, which follow a two-pillar solution (Pillar One and Pillar Two) as developed by the Organisation for Economic Co-Operation and Development (OECD). At present the budget has remained silent on the adoption of Pillar One. Implementation of Pillar Two has now been confirmed.

The announcement states the Government will implement "key aspects of Pillar Two of the OECD/G20 Two-Pillar solution to address the tax challenges arising from digitalisation of the economy". The initiative will include both a 15% global minimum tax and a domestic minimum tax designed to "give Australia first claim on top-up tax for any low-taxed domestic income".

The rules will apply to large multinational enterprises (MNEs) with annual global revenue of EUR750 million (approximately $1.2 billion) or more. This measure is estimated to increase receipts by $370 million and increase payments by $111 million during the five years from 2022–23.

The global minimum tax will apply to large multinationals with Australian operations and is applicable for years starting on or after 1 January 2024, whilst the domestic minimum tax will begin one year later in 2025.

The OECD Pillar Two solution, which the rules are derived from, intends to address the challenges arising from the digitalisation of the economy. The reforms are intended to ensure MNEs pay their fair share of tax in the jurisdictions in which they operate.

The aim of this change is to align the Australian legislation to the changes to the global tax regime already implemented, and to be implemented, by other OECD member countries.

BDO COMMENT

The 1 January 2024 start date for such legislation seems exceedingly optimistic from an ATO and MNE readiness point of view. This expedited timeline does not give the MNEs operating in Australia enough time to understand and implement the required processes to comply with the proposed Pillar Two rules and gain an understanding of the anticipated impacts. This is especially concerning when taking into consideration that many areas of the rules have yet to achieve common alignment by other key jurisdictions and an understanding of the anticipated impacts are yet to be understood.

While Australia may collect some additional tax from select MNEs, the compliance costs to MNEs involved in these measures may substantially outweigh the additional tax revenue. The only real upside is that Australia is seen to be supporting the 15% tax floor that Pillar Two is attempting to impose on a global basis. As Australia's base corporate tax rate is above the 15% tax floor, those measures will level the playing field with lower tax countries by reducing the tax differences between the countries for select MNEs.

Uncertainty remains around the interaction between the Pillar Two regime and the existing Australian tax rules (e.g., loss carry forward, R&D tax offsets) and we anticipate more guidance in this area.

PART IVA GOES INTERNATIONAL

The Government is expanding the scope of the general anti-avoidance rule for income tax (Part IVA of the *Income Tax Assessment Act 1936*) so that it will apply to:

- Schemes that reduce tax paid in Australia by accessing a lower withholding tax rate on income paid to foreign residents
- Schemes that achieve an Australian income tax benefit, even where the dominant purpose was to reduce foreign income tax.

This expanded scope will apply from 1 July 2024, regardless of the scheme's original commencement date.

SCHEMES THAT ACCESS A LOWER WITHHOLDING TAX RATE FOR INCOME PAID TO FOREIGN RESIDENTS

This amendment expands the scope of the rules in a way that is consistent with the recent decision in the *Guardian* case as well as targeting multi-national enterprises. This change may hold implications for variable tax and withholding tax rates such as those enjoyed by Base Rate Entities and Managed Investment Trusts.

SCHEMES PRIMARILY INTENDED TO REDUCE FOREIGN INCOME TAX WITH AN INCIDENTAL OR NON-PRIMARY AUSTRALIAN TAX BENEFIT

This expands the dominant purpose of tax avoidance to include the avoidance of foreign tax obligations and clarifies that these schemes are not acceptable commercial arrangements – even where the Australian tax saving is a collateral benefit of the scheme.

BDO COMMENT

Whilst BDO understands the requirement for robust anti avoidance measures, there is concern around the scope of amendments regarding the dominant purpose test where avoidance of Australian tax is merely a collateral benefit from a much larger scheme. The details of the draft legislation will be heavily scrutinised when released for public consultation.

FRINGE BENEFITS TAX RULES FOR ELECTRIC VEHICLES

The *Treasury Laws Amendment (Electric Car Discount) Bill 2022* (the Bill), which received Royal Assent on 12 December 2022, provides exemptions from Fringe Benefits Tax (FBT) for fringe benefits relating to electric cars, subject to certain requirements being met.

SUNSET ON FBT EXEMPTIONS FOR PLUG-IN HYBRIDS

The Government is sunsetting the FBT exemption for plug-in hybrid electric cars. This change will apply from 1 April 2025. Arrangements involving plug-in hybrid electric cars entered into between 1 July 2022 to 31 March 2025 will remain eligible for the electric car discount.

The Government estimates this measure will increase receipts by $30 million and increase GST payments to the states and territories by $5 million over five years from 2022-23.

BDO COMMENT

The proposed amendments make no changes beyond the Bill already passed in December 2022 and BDO is pleased there will be no further changes. We also note this announcement is in the Budget to recognise the additional revenue that will be raised from the amendment made to the original Bill, which was not accounted for in the previous Budget.

CHANGES TO THE PETROLEUM RESOURCE RENT TAX

On 7 May 2023, the Treasurer announced significant modifications to the Petroleum Resource Rent Tax (PRRT) based on the finalisation of the Treasury Gas Transfer Pricing (GTP) Review.

The current regime imposes a 40% tax on offshore oil and gas projects after they become cash-flow positive, which often takes years or even decades because of the high costs of exploration and infrastructure. Additionally, operation costs are fully deductible and indexed each year.

Effective 1 July 2023, the proposed changes, which have been under consideration since 2019 by the former government, aim to limit the proportion of PRRT assessable income that can be offset by deductions to 90%.

Whilst the cap will not apply until seven years after the project reaches production, these changes bring forward the date at which LNG projects are expected to pay PRRT. In addition to the deductions cap, other modifications to the GTP rules will also be legislated to clearly determine the taxing point and the types of expenditure that are deductible. Furthermore, the anti-avoidance rules will be tightened to prevent any potential exploitation.

The Government plans to consult on the final design and implementation regarding the deductions cap and draft GTP rules in late 2023, while consultation on other policy changes, including the anti-avoidance rules, will occur in early 2024.

BDO COMMENT

BDO is relieved the Government adopted the logical recommendation of implementing the deduction cap, a more reasonable recommendation compared to the complicated ‘netback only’ or ‘modified profit split’ approaches. We do, however, have reservations regarding Treasury’s assertion that this change will not discourage growth in the industry.

While considering the proposed changes to PRRT, accounting issues may not immediately come to mind. However, those organisations that have had to deal with PRRT accounting are familiar with the challenges related to accounting policy choices concerning augmentation and the associated modelling required to recognise deferred tax assets.

The proposed changes may affect the timing and sequence of PRRT credits utilisation, potentially requiring adjustments to recognised deferred tax balances. This exercise will require skills beyond taxation, and reporters may need to seek advice from accounting, modelling and taxation professionals.

LIMITING EXPLORATION FOR PETROLEUM

The Government has proposed an amendment to the Petroleum Resource Rent Tax (PRRT) legislation to clarify the meaning of exploration for petroleum, following the Full Federal Court decision in *Commissioner of Taxation v Shell Energy Holding Australia Limited* [2022] FCAFC 2.

The proposed amendment limits the definition of exploration for petroleum to the discovery and identification of the existence, extent, and nature of the petroleum resource. This does not extend to activities and feasibility studies directed at evaluating whether the resource is commercially recoverable.

Although contrary to the findings in the *Shell Energy Holdings* decision, the proposed amendment is consistent with the ATO's views outlined in Taxation Ruling TR 2014/9, applying to all exploration expenditure incurred from 21 August 2013.

Additionally, the proposed amendment clarifies that mining, quarrying and prospecting rights (MQPRs) are only depreciable when they are used, not merely held. This will apply to all MQPRs acquired or commencing use after 7:30PM on 9 May 2023.

BDO COMMENT

This effort by the Government to narrowly legislate the definition of exploration for petroleum appears to be a knee jerk reaction following the ATO's significant loss in the *Shell Energy Holdings* decision.

The amendment only applies to the PRRT definition of exploration and does not extend to income tax. Although disappointing from a PRRT perspective, the Government does not appear to be attempting to remove feasibility and commercial viability activities from the scope of exploration for income tax purposes. Fortunately for taxpayers, the principles in Taxation Ruling 2017/1 and *Shell Energy Holdings* remain applicable for income tax.

EXTENSION TO GST COMPLIANCE PROGRAM

The ATO will receive $588.8 million in funding from the Federal Government for four years from 1 July 2023 to promote GST compliance. The funding will contribute to the development of more advanced analytical tools for the ATO to identify and address GST risks in the current system, as well as ensuring businesses are accurately reporting and remitting GST as part of their tax obligations. Importantly, the funding will also result in measures that ensure entities are not overclaiming any GST refunds.

To ensure taxpayers are reporting and paying correct amounts of GST, the ATO has and will continue to employ methods such as data-matching and sourcing information from other government agencies to address areas of GST risk. During the five years from 2022–23, the measure is expected to increase GST receipts by $3.8 billion, and other tax receipts by $3.8 billion.

BDO COMMENT

BDO generally welcomes the Government's increased focus on ensuring taxpayers are accurately meeting their GST obligations. Ensuring the integrity of the GST means there is a level playing field for businesses. The use of automated checking systems is also to be applauded for its efficiency.

However, the ATO must acknowledge that the GST provisions are complex and smaller taxpayers may be subject to greater challenges in meeting their tax obligations. Small businesses should be on notice that these measures will result in the ATO identifying greater rates of non-compliance.

EXCISE AMENDMENTS

INCREASE IN TOBACCO EXCISE DUTY

A 5% increase in excise duty on tobacco products in each of the next three years will provide the Government an extra $3.3 billion to fund a crackdown on vaping. The additional revenue will fund public health campaigns and regulatory enforcement measures, including a ban on recreational vaping and restrictions on ingredients and packaging.

The current tax on tobacco is approximately $1.16 per cigarette stick (up to 0.8 grams) or $1,663 per kilogram of tobacco.

The base rate of excise duty (on manufactured tobacco) and equivalent customs duty (on imported tobacco) will increase by 5% each year for the next three years. The announced increases are in addition to the existing indexation occurring in March and September each year.

The Government will spend $234 million to implement a regulatory regime whereby the sale of vapes is limited to pharmacies by prescription only, for people seeking to use vapes to help quit smoking. Additionally, packaging will become 'pharmaceutical-like', all single-use disposable vapes will be prohibited, nicotine content limited, and certain flavours and colours banned.

The changes will be accompanied by targeted public health campaigns.

BDO COMMENT

BDO welcomes the Government's efforts to tackle a growing health concern particularly affecting teens and young people.

ADMINISTRATION FOR THE FUEL AND ALCOHOL EXCISE

The Government will amend measures announced by the previous government that were designed to streamline the administration of the fuel and alcohol excise and excise-equivalent customs goods. The measures were scheduled to commence on 1 July 2023 but will now take effect from 1 July 2024.

The delayed commencement date will apply to measures that:

- Remove overlapping Australian Border Force and ATO systems (provide a uniform business experience)
- Streamline license application and renewal requirements
- Remove regulatory barriers and excise equivalent customs goods (including lubricants, bunker fuels for commercial shipping industries, and vapour recovery units).

Further, from 1 July 2024, the ATO will publish on its website a public register of entities that hold excise licenses to store or manufacture excise and excise equivalent customs goods.

BDO COMMENT

It's likely the delay to the start date of the measures may cause frustration for businesses in the fuel and alcohol industry, as these measures were initially intended to remove the inefficient administrative and compliance requirements they face. The delay in the implementation of these measures will maintain the high costs and red tape associated with doing business in Australia.

REFORM OF THE PRODUCT STEWARDSHIP FOR OIL SCHEME

The Government will increase the Product Stewardship for Oil (PSO) levy by 5.7 cents from 1 July 2023. The PSO levy will increase from 8.5 cents to 14.2 cents per litre for specific oils and greases.

Consequential changes to PSO category 8 benefits will also be made from 1 July 2023, with the Government raising these to 14.2 cents for oils to match the increased PSO levy.

The relevant excise and customs duties to make the scheme more sustainable will also increase.

This measure is estimated to increase receipts by $161 million and increase payments by $22 million, including GST payments to the state and territories of $10 million over the five years from 2022-23.

BDO COMMENT

Whilst the 67% increase in the PSO levy is substantial, BDO welcomes reform of the PSO Scheme to ensure it is properly funded and remains sustainable in the long term. The changes reflect the Government's commitment to the scheme and its ambition to achieve a cleaner climate.

FRANKING CREDITS FUNDED BY CAPITAL RAISINGS

The Government has announced a change to the start date of the tax integrity measure aimed at preventing franked distributions funded by capital raising activities. The proposed measure originally impacted distributions that occurred on or after 19 December 2016. However, under the new announcement, the start date has been changed to 15 September 2022.

Broadly, to the extent distributions are funded by capital raising activities that result in the issue of new equity interests, a company will be prevented from attaching franking credits to the distribution. As a result, the relevant shareholders will not receive the benefit of the associated franking credits.

Under the original measure, the retrospective application would have required taxpayers to amend income tax returns to remove the franking credits previously claimed. Further, this would have required potentially significant top up tax payments for several years.

BDO COMMENT

We strongly support the Government's proposed change because it significantly reduces the potential administrative burden associated with amending historical tax returns. Noting this measure may have unexpectedly impacted numerous taxpayers who through no fault of their own received distributions captured by this measure. While there are still some questions regarding the effectiveness of the original draft legislation, the proposed change is welcomed by BDO.

EXPORT MARKET DEVELOPMENT GRANTS SLASHED

Funding for the already troubled Export Market Development Grant (EMDG) scheme will be reduced by $61 million over four years from 2023-24. Administered by Austrade, the scheme is the Government's longstanding flagship program for supporting Australian SMEs in accessing and growing their overseas markets. As an eligibility-based, non-competitive program it has supported more than 51,000 businesses since 1974.

Despite its rich history, the EMDG program has suffered significant problems in recent years after the former government's review led to a restructure that reduced maximum grants from $150,000 in 2021 to $28,000 in 2023 and average grants from $45,628 to less than $20,000 during the same period. The exporters supported by the program in 2021 employed more than 70,000 Australians and achieved in excess of $4.7 billion in exports for the Australian economy.

Given the scheme's annual budget of $157.9 million, which supports already committed funding as well as administration of the program, these cuts will likely lead to the program being ceased when funds to existing grantees have been fully expended.

BDO COMMENT

This significant cut to funding for the EMDG program is the latest development in a death by a thousand cuts. The previous government's reforms decimated the funding available to small and medium sized exporters, with grant amounts having reduced by up to 93% for some businesses prior to the latest round of cuts. With these cuts, it is highly likely the program will be wound up altogether after finalising committed funding. BDO is highly disappointed to see a once successful and vital export support scheme suffer further under a budget that purports to support small businesses.

INDIVIDUAL MEASURES

INCREASING THE MEDICARE LEVY LOW-INCOME THRESHOLDS

In line with the Government's approach to cost of living relief, the Treasurer has announced an increase in the Medicare levy low-income threshold from 1 July 2022. This increase will apply to singles, families, seniors and pensioners.

THE INCREASES

The thresholds where taxpayers do not pay Medicare levy will increase as follows:

- Singles – from $23,365 to $24,276
- Families – from $39,402 to $40,939
  - For each dependant child or student, the family income threshold will increase by a further $3,760, an increase from the previous amount of $3,619
- Single seniors and pensioners – from $36,925 to $38,365
- Family seniors and pensioners – from $51,401 to $53,406.

LUMP SUMS IN ARREARS

The Government also announced that taxpayers who receive lump sums of income in arrears from their employers (for example, because their wages were previously underpaid), will no longer need to pay Medicare levy on those amounts, where they would otherwise be low-income earners based on the above thresholds. This amendment will apply from 1 July 2024.

BDO COMMENT

Whilst the threshold changes will cost the Government an estimated $460 million during the next five years, BDO commends the Government's recognition of the rising cost of living pressures faced by low-income earning Australians. Although this is a step in the right direction, with the current inflationary pressures facing the country's economy, further assistance to vulnerable Australians may be required in future years.

INCREASED TAX ON SUPERANNUATION BALANCES IN EXCESS OF $3 MILLION

The Government has confirmed its intention to reduce tax concessions for members with total superannuation balances of more than $3 million. The headline tax rate will increase up to 30% - double the existing 15% tax currently being paid by members of superannuation funds not in retirement phase.

The proposal to increase tax on superannuation balances greater than $3 million will be effective 1 July 2025 and will also apply to defined benefit schemes, with interests being appropriately valued and earnings taxed in a similar way to other interests.

Our understanding is that there will be no indexation applied to this $3 million cap, however contribution caps and transfer balance caps are expected to continue to be indexed. While the measure is only expected to impact 80,000 individuals in 2025-26, the number of impacted individuals is expected to increase as superannuation balances increase.

TAX ON UNREALISED GAINS

The proposal introduced by the Government intends to assess all earnings and member balance growth from 1 July to 30 June of each year. The proposed definition of earnings is intended to include unrealised capital gains.

While the Government's intention is to keep the measure simple to administer, while continuing to provide for a dignified retirement, there has been insufficient information received to confirm how this tax will actually be applied in practice.

BDO COMMENT

The Government's intention to introduce a tax on unrealised gains on super funds will be the first of its kind. No other entity in the tax system has ever had to pay tax on unrealised gains before, and this could set a precedent for the taxation of other entities in the future. With the inevitable increase in superannuation balances during the passage of time, more super fund members will be caught.

FURTHER AMENDMENT TO THE NALE RULES

In October 2019, the previous government made changes to the Income Tax Assessment Act to impose non-arm's length income taxes on net revenue where superannuation funds had incurred non-arm's length expenditure (NALE). That legislative amendment has been the subject of much comment and advocacy from industry organisations.

The Budget has clarified some elements of how NALE will operate, namely:

- APRA regulated funds have been entirely excluded from the measures
- The measures will not apply to expenditure that occurred prior to the 2018-19 financial year
- Small APRA funds and SMSFs will continue to be subject to the NALE rules
- Income to which non-arm's length income taxation will apply specifically excludes superannuation contributions.

HOW IS NON-ARM'S LENGTH INCOME TAXATION APPLIED?

In relation to specific investment, if expenditure is not incurred on an arm's length basis, then the net income arising from the investment will be taxed at the non-arm's length income tax rate of 45%.

Where general expenditure has not been incurred on arm's length terms, then an amount equal to double the value of the general expense will be deemed to be non-arm's length income and subject to income tax at 45%.

BDO COMMENT

The proposed changes address the concerns of the superannuation industry in relation to the potential for this measure to unfairly impose high taxes on all the income of the superannuation fund for potentially small non-arm's length expense amounts. However, we do question the policy rationale for excluding APRA regulated funds from the measure entirely.

EXTENSION OF ATO TAX COMPLIANCE AND ANTI-CRIME PROGRAMS

In an effort to combat non-compliance and tax evasion, the Government has announced an extension of personal tax compliance and serious financial crime programs.

ANTI-FINANCIAL CRIME PROGRAMS

From 1 July 2023, the Serious Financial Crime Taskforce and the Serious Organised Crime program will be extended and merged. Previously separately funded programs, the ATO-led collaboration with law enforcement agencies will better target serious and organised crime groups that seek to undermine the integrity of Australia's public finances.

The combined programs are estimated to increase receipts by approximately $279.5 million and payments by $256.6 million over five years from 2022-23. Further, GST payments to the states and territories are anticipated to increase by $32.7 million during the same period.

PERSONAL INCOME TAX COMPLIANCE PROGRAM

From 1 July 2023, the scope of the Personal Income Tax Compliance Program will be extended and expanded. This will allow the ATO to continue delivering preventative, corrective and proactive activities in key areas of non-compliance, and to broaden the program's scope to address developing risk areas.

The funding of this program will allow the Government to undertake compliance activities and detect tax avoidance, notably deductions relating to short-term rental properties.

During the five years from 2022-23, the extension is estimated to increase payments by $90.8 million and increase receipts by $474.9 million.

BDO COMMENT

Whilst the anti-financial crime programs do not have a significant revenue gain for the Government, BDO agrees that ensuring the integrity of the tax system is important because it results in a level playing field for all taxpayers.

The continued focus on individuals will mean more people should expect a call from the ATO about their rental property and working from home deductions.

WELFARE MEASURES

TARGETED RELIEF FOR INDIVIDUALS AND FAMILIES

With a clear target of lowering the cost of living for struggling Australians, the Budget includes a number of substantial welfare incentives and relief measures aimed at low-income and disadvantaged individuals. Whilst there was little comment on tax relief for low- and middle-income earners, plans to expand the welfare system and pensions are set to take a sizeable portion of the Budget.

WORKING AGE PAYMENTS

The Government will increase the base rate of working age and student payments by $40 per fortnight to JobSeeker and other allowance payments commencing on 20 September 2023. It will also extend eligibility for the existing higher single JobSeeker payment rate for recipients aged 60 years and older to recipients aged 55 years and older.

MEDICARE PLAN

The Treasurer announced a $445 million plan to "enable doctors, nurses and allied health professionals to co-operate for better care" as well as a $3.5 billion bulk billing incentive to help GPs provide free consultations. The goal is to lessen the cost and broaden ease of access for those struggling to afford quality care and assistance.

EDUCATION

Funding has been announced to improve the administration of student loans and to enhance the privacy and security of data holdings. Specifically, $42.2 million will be provided to implement a new digital solution to support the VET Student Loans program, $36.9 million will be provided to the Department of Education to optimise the data quality, analytic support and tertiary student loan records, and $8.7 million to extend the VET FEE-HELP student redress measures.

Additional funding of $18.7 million will be provided over four years from 2023-24 to extend and expand existing higher education student support programs. The Government will provide $105.9 million over four years from 2023-24 to strengthen the education portfolio's capability to deliver critical functions. A further $35 million will be provided over four years from 2022-23 to attract more people to the teaching profession and retain more teachers in the workforce.

CHILDCARE

The Budget includes an additional Child Care Subsidy (ACCS) that will provide $2.8 million in the next four years starting from 2023-24 to streamline delivery of the ACCS and expand the exceptional circumstances criteria. The Government will undertake additional payment integrity activities to safeguard the Child Care Subsidy program from fraud and non-compliance.

The Budget also provides $72.4 million over five years from 2022-23 to support the Early Childhood Education and Care (ECEC) sector to build and retain the ECEC workforce. The Government will continue initiatives to support better educational outcomes for First Nation peoples as a key priority under the *National Agreement on Closing the Gap*.

ENERGY PRICE RELIEF

The Government is addressing rising energy prices by providing targeted energy bill relief and progressing gas market reforms. Funding includes:

- $1.5 billion over two years from 2023-24 to establish the Energy Bill Relief Fund to support targeted energy bill relief to eligible households and small business customers
- $14.7 million over five years from 2022-23 (and $2.7 million per year ongoing) to the ACCC to administer and enforce compliance with a temporary cap of $12 per gigajoule on the price of gas and to develop and implement a mandatory gas code of conduct.

WOMEN'S SAFETY

Additional funding has been announced to eradicate gendered violence.

In this regard, the Government will invest a further $326.7 million to improve women's safety, including addressing violence against First Nations women and children, improving justice response for victim-survivors of sexual violence, and expanding family law property pilot programs to improve separating families.

In addition, the Government is contributing funding to the continuation of work to support women who have experienced online harm.

BDO COMMENT

The Budget announcements hold great promise for a better life for the disadvantaged and disenfranchised, and the current year surplus was providing an excellent cushion to start spending. However, we have some concern about the future implications of this high spending, low-investment budget. Small increases to handouts on a grand-scale and free doctors' consultations do not necessarily equate to a better financial future for Australians where the tax streams to fund them are not certain to continue.

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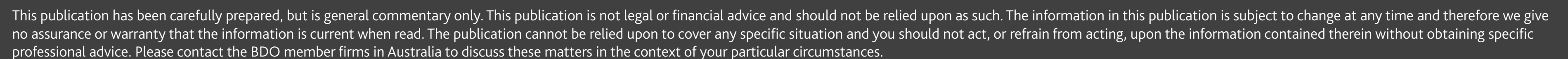

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