Budget Tax Alert

Australia's 2021-22 Federal Budget

Building a better working world

At a glance

- 2021 Federal Budget delivered on 11 May
- Budget measures will be welcomed by small & medium enterprises
- Key business tax changes:
  - Extension of temporary full expensing and temporary loss carry back
  - Patent box tax regime
  - ATO Early Engagement Service
- Employment tax and personal tax measures:
  - Individual residency 'bright line' test
  - Retaining LMITO
  - Employee share schemes reform
- Financial services and superannuation changes

The Australian Federal Budget 2021 was delivered on 11 May 2021 by the Federal Treasurer Josh Frydenberg.

This Tax Alert focuses on the key announced tax measures that impact your business tax planning and compliance processes. The broader economic and overall policy issues in the 2021 budget are outlined on the EY Australia website.

The budget tax measures will be welcomed by small and medium enterprises. Measures which support business investment such as the 12 month extension to the immediate expensing of assets and tax loss carry backs, the new patent box tax regime and the establishment of an Early Engagement Service to expedite clarity on the application of the tax law are highlights. In addition, there are very few additional tax imposts on business, which is a welcome change of approach.

Noteworthy tax measures in the budget include:

- Extension of temporary full expensing and temporary loss carry back measures until 30 June 2023
- A concessional patent tax rate of 17% to apply to income derived from medical and biotechnology patents registered after the Budget announcement
- ATO Early Engagement Service, or "concierge" to support businesses wishing to invest in Australia
- Individual tax residency based on 183 days (or more) physical presence in Australia as a 'bright line' test
- Retaining the Low and Middle Income Tax Offset (LMITO) for the 2021-22 income year
- Employee share scheme reforms
- Other business measures including intangible asset depreciation rates, removal of $450 super guarantee threshold, excise reductions for brewers, digital games development tax offset etc.

It is pleasing to see the adoption of measures advocated by our firm through the Australia as a Financial and Technology Centre Advisory Group (AFTCAG). These include the patent box regime which can be expanded and the so-called ATO 'concierge' service as well as acceleration of the CCIV regime.

Whilst the Australian economy has recovered strongly and the budget deficit is much lower than expected, business investment is still low.

What is needed to accelerate long term growth and productivity are tax measures that would encourage transformative investments by large scale businesses. It is not clear that the extension of the full depreciating assets expensing measure for an additional year is sufficient to achieve this.

The likely introduction of an OECD lead global minimum tax rate brings Australia closer to the field in tax competition for international investment and jobs. This provides an ideal opportunity to leverage Australia's competitive advantages in skills, research base, political and legal institutions and high standards of living with bolder tax settings that incentivise new investment in high value business activities and create well paid long term jobs. It is uncertain if the changes made in this budget are bold enough to achieve this.

Business tax measures

Patent box tax regime

Globally, many jurisdictions offer patent boxes, including the UK and many European countries. These provide a concessional rate of tax for companies that derive income from their IP, to encourage them to perform R&D and house their IP in those countries. Currently, Australian businesses that generate IP do not have access to these same incentives, leaving them in an uncompetitive situation, with companies either forced to pay much higher tax rates, or relocate their IP to other jurisdictions.

This Budget proposes a new patent box regime to curtail this drain on Australian jobs and revenue, with a **concessional patent tax rate of 17%** to apply to income derived from medical and biotechnology patents. In effect, this reduces the applicable tax rate due to income from a patent in Australia from the current 30% rate (for large business), down to 17%. As part of this process, it will be necessary to differentiate between income derived due to the patent, and income due to manufacturing, branding, and other attributes. This will be one of the key design elements of the proposed patent box.

The new patent box tax regime will be limited to patents granted in the biotechnology and medical industries. It is likely the Government will follow the OECD design principles for patent boxes.

There is expected to be a consultation period (including the potential to extend to clean technology industries), with changes due to come into effect from 1 July 2022, and will be applicable to any granted patents that were applied for after the Budget announcement.

Although it is pleasing Australian biotechnology and medical companies will likely benefit from the patent box, it is disappointing that it does not apply to other industries, in particular the Australian technology, fintech and other high-tech sectors that generate and rely on income from patents and R&D.

Temporary full expensing extension until 30 June 2023

Government has responded to submissions by EY and others to extend the existing temporary full expensing rules previously announced in October 2020 to apply to eligible depreciating assets first used or installed ready for use until 30 June 2023. No additional changes to the measures are proposed.

Under the revised measures, taxpayers may claim an immediate deduction for eligible depreciating assets first used or installed ready for use, from 6 October 2020 until 30 June 2023. In addition, second element costs included in the cost of eligible depreciating assets during this period may also be immediately deductible.

Corporate taxpayers with ordinary and statutory income in the 2018-2019 or 2019-2020 income year less than $5 billion may also be eligible for the "<$5billion alternative test". To be eligible taxpayers must meet a more than $100m asset investment test over the 2017 to 2019 income years. Exposure draft legislation with various technical amendments was separately released which clarifies that the cost of buildings which may be deductible under Division 43 can also be included in the assessment of the $100m asset investment test.

Temporary loss carry-back extension

Companies with aggregated turnover of less than $5 billion can already temporarily carry-back company tax losses incurred in the FY20 to FY22 years to offset taxable income in FY19 or later years, resulting in cash refunds of taxes paid in those earlier years (upon lodgement of FY21 and/ or FY22 tax returns). An extension of this measure will allow eligible companies to also optionally carry back (utilise) tax losses from the 2022-23 income year to offset previously taxed profits as far back as the 2018-19 income year when they lodge their 2022-23 tax return.

Extension to Building Better Regions Fund

The Government will continue to support regional Australia through a further $256.5m over 4 years from 2021-22 to the Building Better Regions Fund. This grant funding will support investment into community infrastructure and employment creation aimed at building regional economies.

Technology Investment Roadmap – emissions reduction incentives

The Government has committed $1.2 billion over 10 years (including $643m over 4 years from 2021-22) to drive lowering of emissions by creating the development of regional hydrogen hubs and supporting clean technologies such as carbon capture, use and storage. Support will also be providing a high integrity carbon offset scheme.

ATO Early Engagement Service (AEES)

In order to avoid the risk of new Australian investments being delayed or hampered by ATO processes, the Government has asked the ATO to establish an ATO Early Engagement Service, or "concierge service" to support businesses wishing to invest in Australia.

The concierge service will:

- Provide "up front" confidence to investors about how Australian tax laws will apply be tailored to the particular needs of each investor
- Offer support in relation to any or all federal tax obligations
- Accommodate specific project timeframes, and other time sensitive aspects of a transaction such as foreign investment review board (FIRB) approvals
- Where binding advice is desired, it will also incorporate access to expedited private binding rulings and advance pricing agreements
- Integrate with the tax aspects of the FIRB approval process (if applicable) so that investors only need to provide information once.

The ATO will consult with business and other stakeholders to develop the AEES during May and June 2021. The service will be available for eligible investors from 1 July 2021.

How effective this measure will prove to be will depend on the actual responsiveness, clarity and timeliness of decision making exhibited by the ATO.

Pre-budget announcements

The Government announced several budget tax measures ahead of budget night.

As part of the Government's Digital Economy Strategy:

- **Self-assessing effective life of certain depreciating intangible assets**

  Taxpayers will be allowed to self-assess the effective life of certain intangible assets (such as patents, registered designs, copyrights, in-house software) for depreciation purposes, allowing the acceleration of deductions if taxpayers consider the eligible assets to have a shorter effective life than the statutory life – from 1 July 2023 (aligns to the end of the temporary full expensing of depreciating assets measure). This follows effective life changes to intangibles proposed in 2015 which did not proceed.

- **Digital games tax offset**

  A 30% refundable tax offset will be provided to digital games developers that spend a minimum of $500,000 on qualifying Australian games expenditure (excluding games with gambling elements) with the offset capped at $20m each year – available from 1 July 2022 to Australian companies or foreign companies with a permanent establishment in Australia. Consultation is planned for mid-2021 to determine criteria and definition of qualifying expenditure.

- **Venture capital tax concessions review**

  The Government will undertake a review of the various venture capital tax incentive programs, to ensure current arrangements are fit-for-purpose and support genuine early stage Australian start-ups. Consultation is planned in 2021.

Extension of Junior Minerals Exploration Incentive (JMEI)

Small mining companies are expected to benefit from additional $100m funding to extend the JMEI tax credits program for four more years, which was due to lapse after 30 June 2021.

Excise refund cap increase for small brewers and distillers

Eligible small brewers and distillers will be able to receive a full remission (currently up to 60%) of any excise paid, up to an annual cap of $350,000 (currently capped at $100,000) – from 1 July 2021. Rebates will also become claimable as remission of excise at the time of lodgement of the excise return, eliminating the need to apply for a refund after upfront payment.

Making it easier for small business to pause ATO debt recovery

Small businesses with aggregated turnover <$10m can apply to the Administrative Appeals Tribunal (instead of through the Courts) to pause/modify ATO debt recovery actions where debt is being reviewed by the Small Business Taxation Division of the AAT – from date of Royal Assent.

Financial Services

Corporate Collective Investment Vehicle (CCIV) start date

The previously proposed CCIV will be finalised with an effective date of 1 July 2022. The CCIV was announced in the 2017 Budget and has been the subject of significant industry consultation on the draft regulatory and tax rules.

The proposed CCIV is a corporate structure with flow through tax treatment and is an important vehicle to attract foreign investors that are more familiar with this structure globally, as opposed to the local MIT and AMIT structures.

The CCIV rules were a recommendation of the Johnson Report in 2009 and were also seen as critical to the success of the Asian Region Fund Passport. One of the 15 recommendations of The Australia as a Financial & Technology Centre Advisory Group Report (The Low Report), released in January 2021 was to "Complete the Corporate Collective Investment Vehicle (CCIV) regime, with particular reference to matching the best features of the Singapore VCC structure".

Updated list of Information Exchange Countries

From 1 January 2022, investors who are residents of Armenia, Cabo Verde, Kenya, Mongolia, Montenegro and Oman will be eligible for the concessional 15%

withholding tax on certain Managed Investment Trust distributions.

Rationalising legacy life insurance products and managed investment schemes

The Government will establish an industry working group to develop a streamlined mechanism to address the transfer of interests in legacy funds and life insurance policies. The current adverse tax outcomes and cumbersome process has been a barrier to moving many holders of interests in legacy products into more competitive products. This consultation is well overdue particularly with the impending implementation of the product design and distribution regime which puts additional responsibility for consumer outcomes on product issuers and distributors.

Revisiting licensing relief to Foreign Financial Service Providers (FFSPs)

The Government will revisit the revocation of relief from the requirement to have an Australian financial services licence that was previously available for FFSPs who only provide financial services to wholesale clients and are regulated in sufficiently equivalent jurisdictions or who have limited connection to Australia. The Government will also explore fast-tracking the licensing process for FFSPs who wish to establish permanent operations in Australia. FFSPs are currently in the process of having to obtain a licence before 31 March 2022. This measure will hopefully reduce the compliance burden for entrants to the Australian market and are consistent with recommendations in the Low Report.

Taxation of Financial Arrangements (TOFA) rules amendments

In response to feedback, technical amendments will be made to the TOFA rules that will allow the hedging election to apply on a portfolio hedging basis. This is welcome. There will also be amendments to prevent taxation on unrealised foreign exchange gains and losses unless a specific election has been made. The amendments will apply for transactions entered into on or after 1 July 2022 and there is no indication that any transitional measures will be available.

Removing the preferential tax treatment for Offshore Banking Units (OBUs)

Consistent with the legislation already introduced into Parliament on 17 March 2021, the concessional tax treatment for OBUs will cease for existing OBUs after the 2022-23 income year and no new entrants can enter the regime. The Government will consult on alternative measures to support the industry, although no details as to what they are considering have been provided.

Employment Tax

Simplifying the employee share scheme tax and regulatory framework

The cessation of employment taxing point on tax-deferred employee share schemes (ESS) is to be removed. Disappointingly, the change will not apply to existing awards – only for new ESS interests granted on or after 1 July following Royal Assent (meaning if Royal Assent is not given until after 30 June 2021, the change will only apply to new awards granted from 1 July 2022 at the earliest).

The regulatory framework for employee share schemes will also be simplified. Details are yet to be confirmed, but where a scheme does not require the employee to pay for the equity award, exemptions will apply for disclosure and other regulatory requirements. Where the scheme does involve participants paying for awards (for example, under a loan-based scheme), the regulatory requirements for unlisted companies will be streamlined for ESS offers valued at up to $30,000 per employee per year. The changes are expected to apply from three months after Royal Assent.

Modernising Australia’s individual residency rules

The individual tax residency rules are to be rewritten to provide more certainty. The primary test will be a ‘bright line’ test based on days of presence. A person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident. Secondary tests will apply if the individual is not present for 183 days, with the outcome depending on a combination of physical presence and measurable, objective criteria such as location of family and accommodation and prior years of residence.

This announcement follows an extensive review process undertaken by the Board of Taxation. The new rules will apply from the first income year after the date of Royal Assent of the enabling legislation.

$450 superannuation guarantee threshold to be removed

From 1 July 2022, the Government will remove the $450 per month low income threshold that currently applies for superannuation guarantee. This means that employees that earn less than $450 in a month will now be entitled to receive superannuation contributions from their employer. The Government has indicated it expects this reform to support the retirement incomes of people on low incomes, particularly women.

Superannuation Guarantee contribution rate

There is no change to the 1 July 2021 increase in the superannuation guarantee contribution rate from 9.5% to 10%.

International Tax

Corporate tax residency rules - for trusts and corporate limited partnerships

In the 2020-21 Budget, the Government sought to address uncertainty for foreign incorporated entities by announcing law amendments to provide a company incorporated offshore will be treated as an Australian tax resident if it has a ‘significant economic connection to Australia'. This test is to be satisfied where both the company's core commercial activities are undertaken in Australia and its central management and control is in Australia. The measure is to have effect from the first income year after the date of Royal Assent of the enabling legislation, but the announcement stipulated to give taxpayers the option of applying the revised law from 15 March 2017 (the date on which the ATO withdrew its ruling TR 2004/15).

There was some wishful thinking Treasury might release exposure draft law ahead of the 2021-22 Budget, instead the Government announced it will consult on broadening this amendment to trusts and corporate limited partnerships. The Government will seek industry's views as part of the consultation on the original corporate residency amendment.

Personal Taxation

Personal income tax changes

Non-refundable LMITO retained

As anticipated, the Government has extended the Low and Middle Income Tax Offset (LMITO), which was due to be removed at the end of the 2020/21 income year, retaining it for the 2021/22 income year. Taxpayers with taxable income:

- up to $37,000 will have their tax reduced by up to $255
- more than $37,000 will see offset increase by 7.5c per dollar (maximum $1,080 for incomes $48,000 -$90,000)
- over $90,000 the offset will reduce by 3 cents per dollar in excess, zeroing out at $126,000.

The Low Income Tax Offset (LITO) is unchanged for 2021-22 (maximum $700).

No bracket adjustments

Despite speculation, the Government did not bring forward stage 3 of the personal income tax relief plan announced in the 2019-20 Budget. These income tax cuts are already legislated and commence from 2024-25 income year. The personal income tax brackets remain unchanged for the 2021-22 income year.

Rate* (%)	2021-22 to 2023-24 ($)	2024-25 onwards
0	0 - 18,200	0 - 18,200
19	18,201 - 45,000	18,001 - 45,000
30	-	45,001 - 200,000
32.5	45,001 - 120,000	-
37	120,001 - 180,000	-
45	180,001 +	200,001 +

*Rates do not include Medicare levy of 2%

Medicare levy threshold increases:

The Medicare levy thresholds will also be adjusted from the 2021-22 income year, to take account of recent CPI movements.

Reducing compliance costs for individuals claiming self-education expense deductions

The Government will allow deduction of the first $250 of a prescribed course of education expense, which is currently not deductible, from the first income year after the date of Royal Assent of the enabling legislation. The measure is intended to simplify the tax return process and reduce compliance costs for individuals claiming self-education expense deductions.

Other Superannuation Announcements

Superannuation contribution changes

- From 1 July 2022, the age threshold for making a $300,000 Downsizer Contribution will reduce from age 65 to 60, allowing more individuals to contribute to their superannuation on selling their home, if eligibility criteria are satisfied.
- From 1 July 2022, the 'work test' which requires individuals between the ages of 65-74 to work 40 hours in a 30 day consecutive period before being eligible to make a contribution will be repealed, allowing individuals to contribute to superannuation up to age 74 regardless of their employment conditions.

First Home Super Saver Scheme (FHSSS) changes

The FHSSS maximum releasable amount will increase from $30,000 to $50,000 from the start of the first year after receiving Royal Assent, meaning an individual can contribute up to $15,000 per year in both voluntary concessional and non-concessional contributions and withdraw $50,000 for a first home owner deposit.

In addition, the administration provisions pertaining to the FHSSS are amended to:

- Improve the ability to amend and revoke applications
- Allow individual to amend FHSSS applications including a revocation, withdrawal or amendment as required
- Allowing released funds to be repaid to the Commissioner and that any monies repaid will not count towards the contribution caps and is nonassessable non-exempt income.

SMSFs - retirement legacy conversions

Individuals will be able to convert Market-Linked Pensions, Life-Expectancy and Lifetime Pensions and the associated earnings or reserve amounts to an accumulation or account based pension style account. The conversion will be available for two years commencing the first day of the income year after receiving Royal Assent, noting Centrelink and tax treatment will not be grandfathered for any new pension commenced and reserved amounts converted will be taxed as contributions, but will not count towards the contribution cap.

SMSFs – relaxing residency requirements

The Government will relax residency requirements for SMSF trustee's and small APRA funds, by extending the central management and control safe harbour test from two years to five years and removing the active member test. This measure will be applied the first day of the income year after receiving Royal Assent. This measure will allow SMSF members to continue to contribute to their SMSF whilst working overseas for a temporary period and is welcomed.

For more information please contact:

Business Tax Services (BTS)
Todd Wills
Tel: +61 2 6267 3876
todd.wills@au.ey.com

BTS Tax Policy Services
Alf Capito
Tel: +61 2 8295 6473
alf.capito@au.ey.com

Tony Merlo
Tel: +61 3 8575 6412
tony.merlo@au.ey.com

International Tax and Transaction Services (ITTS)
Sean Monahan
Tel: +61 2 8295 6226
sean.monahan@au.ey.com

ITTS Transfer Pricing
Anthony Seve
Tel: +61 2 9276 9906
anthony.seve@au.ey.com

ITTS Transaction Tax
Reid Zulpo
Tel: +61 7 3243 3772
reid.zulpo@au.ey.com

Global Compliance & Reporting
Andrew van Dinter
Tel: +61 3 8650 7589
andrew.van.dinter@au.ey.com

Financial Services
Antoinette Elias
Tel: +61 2 8295 6251
antoinette.elias@au.ey.com

People Advisory Services
Anne Giugni
Tel: +61 3 8650 7624
anne.giugni@au.ey.com

Indirect Tax
Gavin Shanhun
Tel: +61 8 9429 2209
gavin.shanhun@au.ey.com

Law
Kirsty Keating
Tel: +64 9 300 7073
kirsty.keating@nz.ey.com

Private
Ian Burgess
Tel: +61 7 3243 3711
ian.burgess@au.ey.com

Built Environment and Resources
Colin Jones
Tel: +61 2 9248 4724
colin.jones@au.ey.com

Government Services, Health Life Sciences
Scott Grimley
Tel: +61 8 9429 2409
scott.grimley@au.ey.com

Technology and Consumer Products
Peter Janetzki
Tel: +61 3 8650 7525
peter.janetzki@au.ey.com

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

About EY's Tax services
Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our global teams of talented people bring you technical knowledge, business experience and consistency, all built on our unwavering commitment to quality service – wherever you are and whatever tax services you need.

We create highly networked teams that can advise on planning, compliance and reporting and help you maintain constructive tax authority relationships – wherever you operate. Our technical networks across the globe can work with you to reduce inefficiencies, mitigate risk and improve opportunity. Our 50,000 tax professionals, in more than 150 countries, are committed to giving you the quality, consistency and customization you need to support your tax function.

For more information, please visit www.ey.com/au.

© 2021 Ernst & Young, Australia.
All Rights Reserved.

Liability limited by a scheme approved under Professional Standards Legislation.

SCORE NO: AU00004048
ED None

This communication provides general information which is current at the time of production. The information contained in this communication does not constitute advice and should not be relied on as such. Professional advice should be sought prior to any action being taken in reliance on any of the information. Ernst & Young disclaims all responsibility and liability (including, without limitation, for any direct or indirect or consequential costs, loss or damage or loss of profits) arising from anything done or omitted to be done by any party in reliance, whether wholly or partially, on any of the information. Any party that relies on the information does so at its own risk.