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Federal Budget 2016

Banking

A review of the Budget's major business implications

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Introduction

The Budget headlines will focus on the superannuation changes announced tonight.

For the financial services sector the Budget is a mixed bag of additional integrity measures tempered with some welcome developments.

Despite pre-budget speculation, there were no changes to the thin capitalisation rules announced.

Reduction in corporate tax rate

The Budget contains a complex mechanism to reduce the corporate tax rate for all companies to 25 percent by the 2026-27 income year.

The corporate tax rate reductions phase-in is based on aggregated turnover. Taxpayers with an aggregated turnover of less than $10 million for the 2016-17 income year get an initial reduction to 27.5 percent.

Companies with an aggregated turnover of more than $1 billion must wait until the 2023-24 income year for any relief from the current 30 percent tax rate.

A company's ability to frank dividends will be limited to its prevailing corporate tax rate.

Diverted Profits Tax

A Diverted Profits Tax (DPT) will be added to the existing MAAL measure with effect from 1 July 2017 to complete a package of anti-avoidance provisions applying to significant global entities.

The DPT is based on the second limb of the UK DPT and will apply to transactions that effectively shift profits offshore through related party arrangements that result in tax paid overseas of less than 80 percent of what would have been paid in Australia.

It is also a requirement that the arrangement lacks economic substance and that it is reasonable to conclude that it is designed to secure a tax reduction.

Imposed at a penalty rate of 40 percent of the diverted profits and with a requirement for upfront payment of any DPT liability, this measure will shift the balance of negotiation between the ATO and large business.

There are a number of regional (and global) jurisdictions with corporate tax rates below the 24 percent effective threshold for the DPT to apply. Those with related party transactions with such jurisdictions will need to carefully consider these new rules.

An additional $678.9 million funding for an ATO Tax Avoidance Taskforce focussed on enhanced compliance activities targeting multinationals and others will support these anti avoidance measures.

2015 OECD TP guidelines

From 1 July 2016 Australia's transfer pricing rules will be updated to reference the 2015 OECD transfer pricing guidelines. Currently Division 815 requires it be interpreted so as to achieve consistency with the 2010 OECD transfer pricing guidelines.

Tax Integrity Package

100 fold increase in penalties

If the MAAL and DPT measures were not sufficient to get the attention of multinationals, from 1 July 2017 administrative penalties for significant global entities who fail to meet disclosure obligations will be increased.

The maximum penalty for failing to lodge tax documents with the ATO will increase from $4,500 to $450,000.

Penalties relating to making statements where significant global entities are reckless or careless will be doubled.

OECD Mandatory Disclosure Rules

Treasury is to seek community input on the OECD's BEPS Action 12 proposals for Mandatory Disclosure Rules requiring tax advisors and / or taxpayers to make early disclosures of aggressive tax arrangements.

Whistleblower protection

The Budget proposes better protection under the law for individuals who disclose information to the ATO on tax avoidance behaviour and other tax issues. The measure is to take effect from 1 July 2018.

Anti-hybrid rules

The government has announced it will implement the OECD BEPS Action 2: Anti-hybrid rules taking into account recommendations made by the Board of Tax in its report released tonight. The rules will apply from the later of 1 January 2018 or 6 months after Royal Assent.

Regulated entities will appreciate the acknowledgement that further work is required to determine how these rules should apply to regulatory capital instruments. This will be undertaken by the Board of Tax.

Tax Transparency Code

The final Board of Tax Report on the Tax Transparency Code was released by the government tonight. It recommends the adoption of a voluntary code with two tiers of disclosure requirements.

Taxpayers will welcome the voluntary nature of the code, although a failure to adopt and comply will likely have implications both for non-compliant taxpayers and the ongoing voluntary status of the code.

TOFA simplification

The Budget contains a number of TOFA simplification proposals. These include:

- a strengthened and simplified link to accounting that will presumably reduce compliance costs associated with the reliance on financial reports election
- a simplified accruals and realisation regime that will reduce the number of taxpayers in the TOFA rules
- a revamped hedging regime that removes the direct link to accounting hedging
- simplified rules for the taxation of FX gains and losses.

The Budget suggest the new rules will remove the majority of taxpayers from the TOFA rules. But with reliance on financial reports generally embedded in the banking sector, these changes are likely to offer little other than a possible reduction in compliance costs associated with quantum and timing testing.

The hedging changes should expand the arrangements for which character and timing matching is available and is likely to be of particular interest for funds undertaking portfolio hedging.

Finally, the Budget also commits to a number of previously announced changes to the foreign currency rules, some dating back to 2004.

Consolidation changes

A number of previously announced consolidation changes are further modified in the Budget. Given the level of M&A activity in the financial sector in recent years these further changes will require detailed consideration.

Deductible liabilities

The deductible liabilities rules foreshadowed in the 2013 Budget that required taxpayers to include these amounts in assessable income have been scrapped.

Instead, new measures will apply from 1 July 2016 that exclude the deductible liabilities from ACA calculations resulting in lower tax cost setting amounts for assets.

This will require taxpayers to revisit tax cost setting calculations performed for entities acquired over the last 3 years where the enactment and retrospective application of the 2013 announcement had been anticipated.

Securitised assets

The consolidation changes announced in the 2015 Budget to deal with the inappropriate consolidation outcomes for originators of securitised assets on entry and exit have been expanded to non-financial institutions with securitisation arrangements. The commencement of the amendments has been deferred to arrangements starting after tonight. Transitional arrangements will apply before this time.

Islamic Financing

Without specifically referring to Islamic financing, the Budget announcement to enhance access to asset backed financing would seem to be squarely directed at Shariah compliant arrangements. From 1 July 2018 measures will ensure that asset backed financing arrangements such as deferred payment arrangements and hire purchase arrangements will be treated in the same way as traditional interest based arrangements.

Collective Investment Vehicles

A new tax and regulatory framework will be introduced for two different types of collective investment vehicles. From 1 July 2017 a corporate CIV will be introduced, followed a year later by a limited partnership CIV.

When combined with the recent Asia Region Funds Passport developments, these changes will allow fund managers to offer investments using vehicles more commonly used overseas.

FinTech

The Budget contains changes to the previously announced *National Innovation and Science Agenda*. In the case of venture capital, highlights include extending the increase in fund size from $100 million to $200 million to existing early-stage venture capital limited partnerships and to ensure that the tax concession is available for banking and insurance related activities.

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