AUSTRALIAN FEDERAL BUDGET 2020-2021 – WHAT IT MEANS FOR YOU

Date: 7 October 2020

Tax Alert

CORPORATE TAX RESIDENCE

Consistent with the recommendations contained in the Board of Taxation report to the Government on reforming the corporate residency test, the Government has announced that the law will be amended such that the corporate residency test again reflects the law as it was applied prior to the 2016 High Court decision in *Bywater Investments Ltd v Commissioner of Taxation*.

Prior to the Bywater case, the Australian Tax Office (ATO) interpreted the test for corporate tax residence in a manner consistent with the extensive case law in Australia and overseas, namely that, for a company incorporated outside Australia to be treated as an Australian resident for tax purposes:

- it must carry on business in Australia; and
- either of the following is satisfied:
  - the company's central management and control (CMC) in Australia; or
  - its voting power is controlled by shareholders who are Australian residents.

Following the decision in *Bywater*, the ATO's interpretation of the relevant test was that a company incorporated outside Australia but with CMC in Australia would be considered to carry on business in Australia and be tax resident here. This is so even if its operational activities are wholly outside Australia.

This interpretation created unnecessary uncertainty and, as a practical matter resulted in companies having directors travelling unnecessarily to ensure that the offshore company was not treated as carrying on business in Australia even when it had no operations here.

The Government has announced a revised corporate residency test in the Budget so that a company incorporated outside Australia will only be treated as an Australian tax resident if it has a "significant economic connection to Australia". A company will only satisfy the "significant economic connection" test where both:

- its core commercial activities are undertaken in Australia; and
- its CMC is located in Australia.

This change is to be welcomed and in practical terms this provides more flexibility for the corporate governance of these companies provided their core commercial activities are in another jurisdiction.

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The amendments will have effect from the first income year after the date of Royal Assent of the amending legislation. However, taxpayers can voluntarily apply the new corporate residency test from 15 March 2017.

INSTANT ASSET WRITE-OFF

The Government has increased the instant asset write-off so that businesses with an aggregated annual turnover of less than AU$5 billion will be able to deduct the full cost of eligible capital assets acquired from 7:30pm AEDT on 6 October 2020 and first used or installed ready for use by 30 June 2022.

This measure applies to:

- new capital assets and enhancements to existing assets; and
- second-hand assets, if purchased by businesses with turnover of less than AU$50million.

Expanding upon the previously announced instant asset write-off and accelerated depreciation measures, the Budget has removed all write-off thresholds and allowed a deduction for the full cost of the asset in the first year.

For example, AusCo had an aggregated turnover of AU$20 million for the income year ended 30 June 2020. On 7 October 2020, AusCo acquired a truck for AU$200,000 and leased it to a logistics business under a standard operating lease. AusCo is able to immediately deduct the full cost of the motor vehicle in its income tax return for the year ended 30 June 2021.

In respect of second-hand assets, businesses with aggregated annual turnover between AU$50 million and AU$500 million will still be able to deduct the full cost of eligible second-hand assets with a cost of less than AU$150,000 that are purchased by 31 December 2020 under the enhanced instant asset write-off.

Businesses that hold assets eligible for the enhanced AU$150,000 instant asset write-off will have an extra six months, until 30 June 2021, to first use or install those assets.

Designed to encourage spending by providing immediate tax relief, this measure is expected to result in improved cash flow and essential investment and drive economic growth.

Businesses eligible for these incentives should consider the timing for purchases of eligible capital assets to ensure that they are within the relevant deadlines.

FRINGE BENEFITS TAX (FBT)

The Government has announced a new FBT exemption for retraining employees who have either been made redundant or who are about to be made redundant where the retraining may not be related to their current employment.

Ordinarily, FBT would apply at a rate of 47%. As such, this is a welcome move as it removes the disincentive to provide departing employees with retraining opportunities to set them up for their next career (including redeployment elsewhere in the existing employer's business).

For example:

Description	With FBT (AU$)	FBT exempt (AU$)

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Description	With FBT (AU$)	FBT exempt (AU$)
Retaining cost before tax ($1,000 cost per employee x 10 employees)	$10,000	$10,000
FBT Payable (Type 1 gross-up)	$9,777	Nil
Total cost (after tax)	$19,777	$10,000
Corporate tax rate	30%	30%
Total cost (after tax)	**$13,844**	**$7,000**

The Government has also announced that it will consult on potential changes to allow an individual to deduct education and training expenses they incur themselves where the expense is not related to their current employment.

In a win for the reduction of FBT administration costs, the Government will also provide the ATO with increased powers to allow employers to rely on existing corporate records instead of requiring employers to obtain declarations from employees. This measure will apply from the FBT year commencing 1 April after the enabling legislation is enacted. This should go some way to easing the FBT compliance burden.

TEMPORARY LOSS CARRY-BACK REGIME

In a climate where businesses are being forced to be innovative and change business models, companies' ability to satisfy the various loss recoupment tests, (ie continuity of ownership test, same business test and similar business test) have been severely impacted. Rather than imposing restrictions, as perhaps what was initially expected by industry, the Government has instead reintroduced the loss carry-back provisions (these were previously introduced by the Labour Government in 2012-13 but subsequently repealed in 2014).

Now aligned with the jurisdictions, including New Zealand, the U.S. and the UK, eligible corporate entities with a turnover of less than AU$5 billion may carry-back losses generated in the 2019-20, 2020-21 or 20201-22 financial years to previously taxed profits in the 2018-19, 2019-20 and 2020-21 financial years, and thereby, generate a refundable tax offset in the year in which the loss is made.

The amount of the tax refund will be limited by the corporate entity's income tax liabilities and franking account balance in the relevant year. For example, the loss carry-back cannot be more than the earlier taxed profits, or generate a franking account deficit.

The tax refund will be available on election by eligible businesses when they lodge their 2020-21 and 2021-22 income tax returns. Companies that do not elect to carry-back losses under this measure can still carry losses forward as usual.

LIST OF EXCHANGE OF INFORMATION JURISDICTIONS

Distributions made by a managed investment trust (MIT) to investors are currently subject to a reduced rate of withholding tax of 15% (as opposed to a maximum of 45%) where the investor is a resident in a jurisdiction which is listed as having an "effective" information sharing agreement with Australia.

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In the Budget, the Government is extending the list of these countries to include a number of jurisdictions, the most significant of which from an inbound investment perspective will be Hong Kong and Kuwait. Kenya will be removed from the existing list.

These changes will be effective from 1 July 2021, and have been designed to encourage foreign investment into Australia.

RESEARCH & DEVELOPMENT (R&D) TAX RELIEF

The Government has announced further amendments to its R&D tax incentive reforms which were first announced in the 2018-19 Federal Budget. It is intended this will encourage companies to engage in R&D benefiting Australia particularly in light of COVID-19.

Effective 1 July 2021, companies with an aggregated annual turnover of AU$20 million or more, will continue to be rewarded based on their "R&D intensity", (ie R&D spend as a proportion of total spend), but with two rather than three intensity tiers, and with an increased tax offset rate, as tabled below:

R&D tax intensity	**R&D tax offset rate**
0% and 2%	Company tax rate plus 8.5% (eg 38.5% for companies with a 30% corporate tax rate)
Above 2%	Company tax rate plus 16.5% (eg 46.5% for companies with a 30% corporate tax rate)

The Government will proceed with increasing the cap on eligible R&D expenditure from AU$100 million to AU$150 million per annum, and all other previously announced measures will remain unchanged.

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