



2018 FEDERAL BUDGET REPORT

It's about the journey, not the destination.

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INTRODUCTION

“...you can't have both
#takemytendollars...”

While the 2018 Federal Budget has handed down a number of measures that are welcomed, particularly for battlers, baby boomers, and craft beer brewers, the pilgrimage to real tax reform continues to be overshadowed by what seems to be a detour towards the next election. In our Tax Reform Survey conducted recently, 79% of respondents stated that tax reform should not be beholden to the electoral cycle. So it is disappointing that this opportunity for holistic tax reform has been lost to short term political realities.

The announced personal income tax cuts, while providing some relief to lower income earners (although if you stop for refreshment you'd have to choose between a hamburger or a milkshake – you can't have both *#takemytendollars*), unfortunately serve to inject more complexity into the system. Middle to high income earners don't see any significant relief

until 2024 – which is two electoral cycles away. At a time when our tax system should be made more simple, measures make the journey for real reform a longer road to travel.

Where this budget over-delivers is in its pursuit of tax 'integrity' in all shapes and sizes. The measures designed to target the black economy are overdue. Denying a tax deduction to businesses that fail to withhold tax from employees' wages and payments to contractors is a measure that should be given an inside lane through parliament. It is easy to determine compliance and does not impose costs on businesses that do the right thing.

On the other hand, the proposal to deny deductions to holders of vacant land offends against a central tenet of the design of our tax system. It is also hard to apply at the margins and imposes compliance costs on taxpayers who are doing the right thing. If it has



justifications, they are not evident from the budget papers. This measure should be given a long drive off a short pier.

The new R&D announcement will mean our global competitiveness in attracting innovative companies will continue to suffer, mainly because companies cannot be certain of their tax outcomes before they spend money. We want Australia to be seen as a popular destination for business. Instead, we run the risk of becoming a sleepy backwater, bypassed by the highway of technological advancement.

Despite this year's budget representing yet another disappointing lost opportunity to reshape our tax system, and like a nagging toddler from the back seat, BDO will continue to advocate for holistic tax reform. With real reform still firmly entered in our GPS, we only hope the Government doesn't lose the signal, otherwise we may run out of gas before we get there.



INDIVIDUALS, TAX CUTS & SUPERANNUATION



WILL TAX CUTS BE SEEN AS INCENTIVE OR INSULT?

In a move to attract swinging voters, the Budget has revealed a seven-year personal income tax cut plan commencing 1 July 2018.

The Budget measure addresses tax pressure in three steps:

1. Immediate tax relief for low to middle income earners to ease cost of living pressures
2. Protection from bracket creep
3. Wide ranging personal tax savings.

Immediate effects

The provision of immediate tax relief will be delivered in the form of a new Low and Middle Income Tax Offset (capped to \$530 per annum).

The new Income Tax Offset will provide a benefit of up to \$200 per year for taxpayers earning under \$37,000, and up to \$530 for those earning between \$48,000 and \$90,000 per annum.

From \$90,000, the new offset will phase out at 1.5c per dollar (until \$125,333 per year).

These measures will commence from 1 July 2018 and run until 30 June 2022.

Protection from bracket creep

The second step of the seven-year Budget plan is to protect taxpayers, particularly those in the middle income tax brackets, from the effects of bracket creep.

The first line of defence will be the increase of the 32.5% tax rate threshold from \$87,000 to \$90,000, commencing 1 July 2018.

This will be bolstered by a further increase from \$90,000 to \$120,000 from 1 July 2022. The threshold for the 19% tax rate will also increase from \$37,000 to \$41,000 from this date, as illustrated in the table below:

TAX RATES & THRESHOLDS			
Rate	Current	2018-19 to 2021-22	2022-23 and 2023-24
0%	\$0 - \$18,200	\$0 - \$18,200	\$0 - \$18,200
19%	\$18,201 - 37,000	\$18,201 - 37,000	\$18,201 - 41,000
32.5%	\$37,001 – 87,000	\$37,001 - 90,000	\$41,001 - 120,000
37%	\$87,001 - \$180,000	\$90,001 - \$180,000	\$120,001 - \$180,000
45%	\$180,001+	\$180,001+	\$180,001+

The above threshold increases will be further reinforced by an increase to the Low Income Tax Offset (LITO) from \$445 to \$645 from 1 July 2022.

Wide ranging tax cuts

The final step in the Budget plan is the introduction of personal tax cuts for the majority of the taxpayer population delivered in the form of an abolition of the 37% tax rate bracket and increase in the top marginal rate threshold from 1 July 2024.

This means that taxpayers would enjoy a tax rate of 32.5% on income from \$41,000 to \$200,000.

This would give the Coalition the bragging rights of having approximately 94% of all taxpayers facing a marginal tax rate of 32.5% or less in the 2025 income year.

BDO COMMENT

The first two steps in the proposed plan provide, at best, modest tax pressure relief to taxpaying households. The hashtag #keepmytendollars is rapidly making its way around social media circles and is evidence of the general feeling of apathy toward these initial measures. While BDO clients may benefit from these cuts in a small way, it is more of the same tinkering around the edges of a clunky tax system.

However, in the event the Coalition is in a position to make good on Step 3 of the proposed plan in July 2024, we could see some meaningful changes to the disposable income of households.

The closing gap between personal tax rates on income up to \$200,000 and the corporate tax rate, together with the changes to the Division 7A provisions could see a real change in the focus of tax planning for families running small to medium businesses and high net worth individuals.

PROTECTING SUPER AND NEW FLEXIBILITY WITH SMSFS

Several measures have been proposed, which are essentially designed to protect superannuation balances against erosion by fees, and which also introduce flexibility in the way that self-managed superannuation funds (SMSFs) can be used by larger groups of individuals. The measures provide initiatives which should benefit individuals in various ways.

Capping passive fees, banning exit fees and reuniting small and inactive superannuation accounts

From 1 July 2019, it is proposed that a 3% annual cap will be introduced on passive fees charged by superannuation providers (ie. industry, retail, corporate and government funds), where the individual's account balance in that fund is below \$6,000. In addition, the imposition of exit fees by any type of superannuation fund will be prohibited from the same date onwards.

There is a further proposal that all inactive superannuation accounts with balances of less than \$6,000 must be transferred to the ATO. From there, the ATO will expand its data-matching processes to attempt to reunite these inactive accounts with any active accounts of the relevant members.

BDO COMMENT

Although these proposals may have a positive impact on protecting superannuation savings from erosion by fees, it will be of interest to determine how the reunification of lost and inactive accounts will be achieved in practice.

Increasing the number of members of private superannuation funds and preventing inadvertent contribution breaches

From 1 July 2019, it is proposed that all SMSFs and small APRA funds will be allowed to have a maximum of six members, being an increase from the current limit of four individuals.

It is also proposed that any individuals whose income exceeds \$263,157 per annum, and who have multiple employers, will be able to nominate that their wages from specified employers are not subject to the superannuation guarantee. This measure would apply from 1 July 2018, and is aimed at ensuring that unintentional breaches of the \$25,000 annual concessional contributions cap do not occur (resulting in excess contributions tax), in circumstances where there are multiple obligations to make compulsory superannuation guarantee contributions.

BDO COMMENT

Allowing up to six members of private superannuation funds provides greater flexibility in numerous family situations, and eliminates the additional costs of forming and operating more than one fund. The proposal to allow certain wages to be exempt from superannuation guarantee is welcome and will assist many in certain industries (eg. locum medical practitioners), and has been sought by the industry for some time.

THE GOVERNMENT JUST CAN'T LEAVE SUPERANNUATION ALONE

A range of changes to the superannuation system applying to individuals have been announced in this year's Budget.

Changes to the work test

The Government has proposed to allow for some individuals between the age of 64-75, to make voluntary contributions without passing the work test requirements.

Currently, members between the age of 65-74 must work at least 40 hours in a 30-day consecutive period in the financial year they wish to make a voluntary contribution. The proposed legislation will allow members aged between 65-74 to make voluntary contributions in their first year of retirement, provided they have a total superannuation balance of less than \$300,000.

Some of our senior population will benefit from this proposal with the ability to top up their superannuation balances one last time, and gain a tax benefit through the ability to claim a tax deduction in their personal tax returns for concessional contributed amounts.

BDO COMMENT

For some time, BDO has encouraged the abolition of the work test. Whilst there is little more freedom in these proposed measures, we believe the restrictions are too onerous and this will result in more administration complexity and cost for Australians.

Personal deductible contributions integrity measure

The Government is proposing to improve their ability to capture information for members claiming personal tax deductions for concessional contributions.

The proposed measure has been introduced to ensure that the required tax is being paid on personal concessional contributions, where the individual's tax return does not

mirror the superannuation fund data. The proposed legislation will require individuals to declare that they have complied with the requirements to submit a 'notice of intent' (NOI) in their individual income tax returns.

Currently, where individuals intend to claim a personal deduction for super contributions, a NOI form is required to be sent to the Fund and a written response sent back to the member from the Fund.

The proposed legislation indicates that the NOI form will still be required. This change will not provide any administration ease for members, but will educate them as to the requirements of claiming a deduction for a contribution.

BDO COMMENT

Given the ATO's access to real time data and ability to data match, BDO is surprised that the ATO is still relying on a manual process when the individual's tax return is lodged.

SMSF Audits

From 1 July 2019, some self-managed superannuation funds (SMSFs) will only be required to have an independent audit conducted on their fund's financial statements and the fund's compliance with the supervisory legislation every three years. It is proposed that this requirement will apply to SMSFs with a history of three consecutive years of unqualified audit reports and that have lodged the fund's annual returns in a timely manner.

BDO COMMENT

While encouraging red tape reductions, BDO is concerned that reducing audit requirements from annual to every three years could result in an increase of inadvertent and unrecognized SMSF non-compliance. This could ultimately lead to increased costs for SMSFs to rectify longer outstanding non-compliance matters.

COST RECOVERY OF SUPERANNUATION ACTIVITIES

The Government proposes to recover the cost of superannuation related activities undertaken by the Australian Taxation Office (ATO), by increasing the Financial Institutions Supervisory Levy (FISL). The increase in the levy from 1 July 2018, is estimated to raise \$31.9 million dollars over four years and will be raised in a manner consistent with the Australian Government Cost Recovery Guidelines.

While the increase in the FISL is intended to cover the full cost of ATO superannuation related activities, the Budget Papers do not state what the amount of the increase will be.

BDO COMMENT

The Government is increasingly focused on recovering the cost of Government departments carrying out their regulatory activities by increasing the levies applied to business. A recent example of this was when the Australian Securities and Investments Commission announced that the one off cost of registering as an SMSF auditor would increase from \$107 to \$3,429.

As the Government has not specifically stated how much the FISL will be increased, we remain concerned that significant increases could be imposed.





BUSINESS & INVESTMENT

CRAFT BREWERS AND DISTILLERS GET A BREAK

As part of the 2018-19 Federal Budget, the Government has introduced new measures to level the playing field for Australian craft brewers and distillers. Eligible Australian alcohol producers will be able to claim a refund on 60% of the excise duty paid up to a cap of \$100,000 per financial year. The change will take effect from 1 July 2019 and represents a significant increase from the current cap of \$30,000 per financial year.

The concessional draught beer excise rate will also be extended to include smaller kegs. Prior to these changes, draught beer sold in kegs greater than 48 litres had been taxed at a lower rate. This has presented a significant disadvantage for smaller breweries. The concessional excise rates are now to be extended to kegs greater than 8 litres, allowing craft breweries to enjoy similar allowances as their larger competitors.

BDO COMMENT

BDO welcomes these changes. The Australian brewing industry continues to grow and the number of breweries in Australia has increased from 30 to 379 between 2006 and 2016. While these changes are encouraging, the reforms still do not place breweries on equal footing with wineries, who receive more generous producer rebates of \$350,000. There is further scope for the Government to continue to expand this important and successful program for local industry.

INSTANT ASSET WRITE-OFF FOR SMALL BUSINESS EXTENDED FOR 12 MONTHS

The Government will extend the current instant asset write-off for Small Business Entities (SBEs) that it introduced in the 2016 Budget by 12 months to 30 June 2019. The threshold amount was due to return to \$1,000 on 1 July 2018.

To take advantage of the write-off, the taxpayer must be a business with aggregated annual turnover of less than \$10 million. However, as a result of this announcement, SBEs will continue to be able to immediately deduct eligible assets costing less than \$20,000 which are first used or installed ready for use by 30 June 2019 for a taxable purpose.

This concession extends to small business simplified depreciation pools and continues to allow eligible taxpayers to place assets valued at \$20,000 or more (that cannot be

immediately deducted) into a small business simplified depreciation pool and depreciate these assets at 15% in the first income year and 30% each income year thereafter. In addition, the concession continues to allow taxpayers to write-off the pool balance where the total written down value is less than \$20,000.

BDO COMMENT

While BDO embraces the extension of the write-off, providing long term incentives as opposed to uncertain year on year extensions would be preferable. This will allow SBEs to plan large asset purchases without imposing artificial deadlines.

OVERHAUL OF THE R&D TAX INCENTIVE

As predicted, the Government has announced a number of proposed changes to overhaul the R&D tax incentive. These changes are based on the recommendations that came out of its 2016 review of the R&D tax incentive and the subsequent 'Australia 2030: Prosperity through Innovation Report' released in January this year by the Board of Innovation and Science Australia (ISA).

However, despite its considerable investment in these two reviews, the Government has chosen to go further with additional complexity that it believes will reduce the 'exploitation' of the R&D tax incentive by large (>\$20m turnover) companies. In particular, the Government will introduce a tiered intensity threshold system to the non-refundable offset.

Notably, the Government has chosen to ignore the recommended premium incentive for collaboration with publically funded research organisations – a measure which was strongly endorsed in the Board of ISA's report.

These changes are due to take effect from 1 July 2018.

Proposed changes to the refundable tax offset (applicable to companies with <\$20m turnover)

- ▶ Tie the offset rate to the claimant company's tax rate and fix the offset rate at 13.5% above the relevant company tax rate
- ▶ Introduce a \$4 million cap on the annual cash refund payable under the R&D tax incentive, with remaining offsets to be treated as non-refundable tax offset carried forward for use against future taxable income
- ▶ Clinical trials will be exempt from the \$4 million cap.

Proposed changes to the non-refundable offset

For companies with aggregated annual turnover of \$20 million or more, the Government will introduce an R&D premium that ties the rates of the non-refundable R&D tax offset to the incremental intensity of R&D expenditure as a proportion of total expenditure for the year. As explained in the table below, the marginal R&D premium will be the claimant's company tax rate plus:

- ▶ Four percentage points for R&D expenditure between 0% to 2% R&D intensity
- ▶ Six and a half percentage points for R&D expenditure above 2% to 5% R&D intensity
- ▶ Nine percentage points for R&D expenditure above 5% to 10% R&D intensity
- ▶ Twelve and a half percentage points for R&D expenditure above 10% R&D intensity.

R&D INTENSITY (AS A PORTION OF TOTAL COMPANY EXPENSES)	ADDITIONAL INCENTIVE COMPONENT ABOVE COMPANY'S CORPORATE TAX RATE
0-2%	4%
2-5%	6.5%
5-10%	9%
10%+	12.5%

R&D premium example for a company with an annual turnover greater than \$20 million dollars

The Budget papers contain an example of a company with a 30% tax rate that has incurred \$120 million of R&D expenditure as part of its total \$300 million of expenditure for the year. The company will have an overall R&D intensity of 50%. It claims the non-refundable R&D tax offset at a rate of:

- ▶ 34% for the first \$6 million of R&D expenditure (equating to a 4% net after tax benefit)
- ▶ 36.5% for the next \$9 million of R&D expenditure
- ▶ 39% for the next \$15 million of R&D expenditure
- ▶ 42.5% for the final \$90 million of its R&D expenditure.

We note that there is no comment as to how taxable subsidiaries of tax exempt entities will be treated. These entities are currently only entitled to the non-refundable offset.

Additional Measures

- ▶ The expenditure threshold will increase from \$100 million to \$150 million so that large R&D-spend companies retain an incentive to increase R&D in Australia
- ▶ Other changes include improving the transparency of the program by enabling the ATO to publicly disclose claimant details and the R&D expenditure they have claimed, limits on time extensions to complete R&D registrations and amendments to technical provisions (such as the feedstock and clawback rules and the general anti-avoidance rules).

Other measures relating to science and innovation

Although the Government is making cuts to the R&D tax incentive, this is being offset somewhat by additional measures in other areas of technology and science. Such measures include:

- ▶ Providing \$29.9 million to support Artificial intelligence (AI) and Machine Learning (ML) via targeted Cooperative Research Centres Programs, PhD scholarships and education, and frameworks for future investments
- ▶ Allocating \$41 million to promote the Australian Space Industry via the establishment of a National Space Agency and International Space Investment project
- ▶ Attempting to increase export capability and cooperation between Australian businesses by allocating \$20 million to the establishment of a Small and Medium Enterprise Export Hubs program
- ▶ Providing \$20 million to expand the Global Innovation Strategy grant program, including the establishment of a funding stream targeted at Asia
- ▶ Providing \$36 million to enable widespread access to standardised satellite data
- ▶ Contributing \$70 million to replace and improve components at the Pawsey Supercomputing Centre
- ▶ Providing a total of \$1.3 billion for a National Health and Medical Industry Growth Plan, which will utilise proceeds from the Medical Research Future Fund to promote areas such as genomics research, clinical trial programs and industry research collaborations.

BDO COMMENT

BDO is disappointed that the Government is seeking to reduce its investment in the R&D tax incentive in a time of rapid change and increasing globalisation. According to ISA, the top priority of Australia's innovation policy should be to increase business expenditure on R&D to push us to the forefront of the global innovation race. It remains BDO's view that the most efficient and fairest way to support business R&D is through the tax system and not through discretionary direct funding.

Capping the refundable offset

Whilst BDO is pleased the Government has increased the proposed refundable cap to \$4 million from the originally proposed \$2 million, concerns remain for how this cap will impact entities already heavily invested in large R&D projects. Whilst only a small number of applicants will be impacted by the proposed cap to the refundable offset, these are companies that generally achieve the high levels of R&D intensity that are the target of promotion by the Government. In addition, these are the companies that are the most responsive to fiscal incentives in regards to generating additionality and spill overs.

Further, BDO is concerned that the exemption of clinical trials from this cap suggests partiality in the otherwise broad based, industry agnostic programme.

Intensity Thresholds

The changes to the non-refundable offset could provide a benefit to larger R&D intensive entities. However, we have significant concerns that the non-refundable offset constitutes a move away from a focus on the qualitative features of the R&D being conducted to the extent of the businesses investment in R&D as a proportion of total cost.

The intensity thresholds for larger businesses add significant uncertainty and complexity to an already complex area of



the tax law. If this measure is passed, all companies with a turnover greater than \$20 million will need to reassess whether there is sufficient incentive to comply with the rigorous substantiation requirements of the program. Such a measure may lead to some companies dropping out of the system or to conduct their R&D in more favourable jurisdictions. Complexity can also lead to manipulation – something the measures are purportedly designed to fix.

In particular, BDO notes that:

- ▶ The thresholds will reduce certainty around quantum of a claimant's benefit as the threshold triggers have to be calculated on a retrospective basis at year end and cannot be determined in advance of conducting R&D activity
- ▶ A tiered system adds additional administrative burden to all stakeholders, and the design of the mechanism could be open to manipulation – such as the method used for calculating the total annual expenditure. It is unclear from the budget papers whether the threshold is based on the company, R&D entity or group expenditure. We suspect the proposed changes to the anti-avoidance measures might be designed to address any concern here
- ▶ We could now have a scenario where two large companies are conducting similar R&D programs and depending on (presumably) group expenditure, one may only get a 4% cost underwrite whilst another will get up to 12.5% cost underwrite due to factors completely unrelated to the R&D itself.

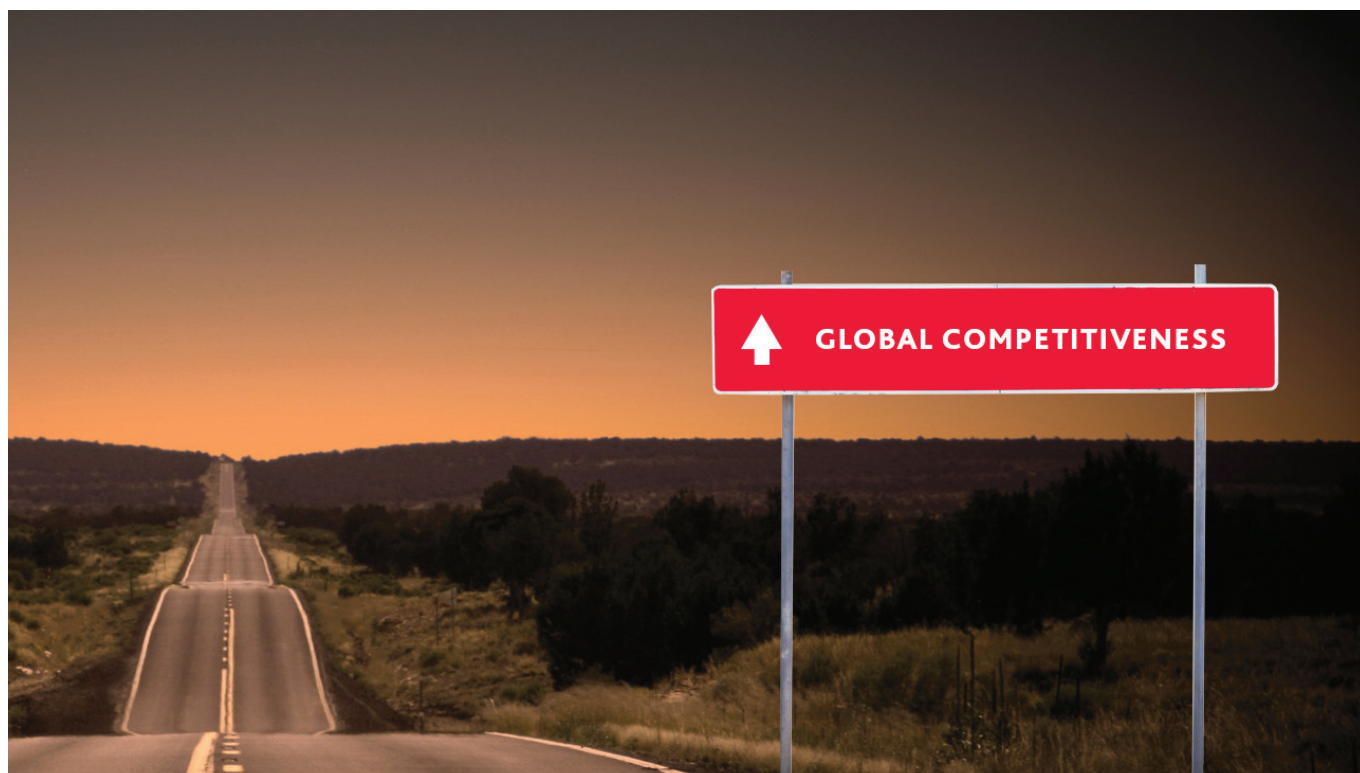
In light of the above, the introduction of the thresholds should be avoided, as they discriminate against high turnover low margin businesses and, in doing so, would unfairly target some of Australia's most globally competitive industries. It also disadvantages existing businesses diversifying into new areas of technology development investment, substantially increases administrative burden, and further reduces certainty around the R&D tax incentive programme for all claimants.

Increase the expenditure threshold

BDO welcomes the proposed increase in the expenditure threshold. However, it is our view that despite the proposed increase in the expenditure threshold to \$150 million, the introduction of the intensity thresholds is likely to reduce the appeal of Australia's R&D tax incentive programme, especially for large companies who have the discretion of choosing where to conduct their R&D activities.

Transparency of the programme

We understand the Government will give the ATO the power to publicly disclose claimant details and the R&D expenditure they have claimed. We recommend the Government carefully consider the full array of implications that could arise from releasing R&D expenditure values to the general public. Simply releasing financial information without greater context could place undue attention on legitimate claimants.



TAXATION OF TAX EXEMPT ENTITIES

Periodically, entities that have previously been income tax exempt can transition to operate in the same manner as traditional business taxpayers.

Where income tax exempt entities transition to being taxable after 8 May 2018, any income tax deductions that arise on the repayment of the principal of a concessional loan will be disallowed.

Under this measure, impacted concessional loans will be required to be valued as if the loans were originally entered into on commercial terms.

BDO COMMENT

This measure is an integrity measure necessary due to the interaction between the taxation of financial arrangements (TOFA) rules and those rules dealing with deemed market values for tax exempt entities that become taxable. While this is a small group, affected parties will need to carefully consider their circumstances.

SIMPLIFYING TAX CONSOLIDATION

The Government has simplified two previously announced tax consolidation integrity measures.

Measures were announced in the 2013-14 Budget to prevent non-residents from 'churning' assets between consolidated groups to generate double deductions. The Government has deferred the start date of one aspect of the measure, which requires grouping of associates when considering whether the integrity rules apply. These grouping rules now apply from the date of introduction of the enabling legislation.

The 2016-17 Budget announcements removed adjustments relating to

deferred tax liabilities from the consolidation entry and exit tax cost setting rules. The measure contained complex transitional rules which required taxpayers to determine if any deferred tax liabilities were included in entry tax cost setting calculations — if so, the measure would not apply. Following consultation, those complex transitional rules were removed from the final legislation.

BDO COMMENT

It's promising to see the Government has taken on board feedback from BDO and the wider tax profession. With the tax consolidation rules growing in complexity, a simplification is a welcome breath of fresh air.

Yet again, however, we see significant delays between the announcement of new legislation and its introduction. This time lag needs to be addressed.

EXPANDING THE DEFINITION OF A LARGE MULTINATIONAL

How a large multinational, or 'significant global entity' (SGE), is defined is of special importance as the ATO requires certain additional compliance measures from SGEs. It is proposed to expand the definition of an SGE to include a few more types of group structures in order to ensure that certain large multinational companies are not falling through the cracks under the current definition of an SGE.

Current definition of an SGE

An entity is determined as an SGE if itself, or as a member of a group of entities (consolidated for accounting purposes as a single group) it had an annual global income of \$1 billion or more during a year.

Under the current definition:

- ▶ For an entity that is a part of a group of entities, earning an annual global income above the

\$1 billion threshold, the decisive factor becomes whether the group is headed by a public or private company that is required to provide consolidated financial statements

- ▶ A subsidiary excluded from the consolidated financial statements of its global parent entity (GPE) because the GPE is an investment entity, is not an SGE.

Amended definition of an SGE

The SGE definition will be broadened by the Government to ensure that certain other large multinational companies also come under the definition of an SGE. The new definition will include members of large global groups headed by private companies, trusts and partnerships.

Further, the new definition will include entities that are members of groups headed by investment entities.

The extended definition means that a broader set of entities will be required to comply with Country-by-Country Reporting (CbCR) obligations, the Multinational Anti-Avoidance Law (MAAL), the Diverted Profits Tax (DPT) and the substantially increased penalty regime.

The amended definition of an SGE will apply to an entity's income period starting on or after 1 July 2018.

BDO COMMENT

The broadening of this definition will impact large multinationals who previously fell out of the definition of an SGE due to their group structuring. This expansion of the SGE definition translates to certain large global companies being required to undertake an additional administrative burden.

From a broader global perspective, the OECD has not yet amended their definition of an SGE, but BDO predicts that this may not be the case for long as, much like the ATO, other tax authorities may also come to notice that certain global companies have been structuring to avoid similar provisions.

TAXATION OF FINANCIAL ARRANGEMENTS (TOFA) CHANGES DEFERRED

TOFA changes announced in the 2016-17 Federal Budget have been deferred.

The previously announced changes were due to apply to income years commencing on or after 1 January 2018. The Government has deferred the start date to income years commencing on or after the date of Royal Assent of the enabling legislation. The reason for the deferral is to allow additional time for the design of the rules, to ensure that unintended consequences do not arise and that compliance cost savings are achieved.

The 2016-17 Federal Budget announced changes related to four key components:

- ▶ A 'closer link to accounting' to better align tax and accounting treatments
- ▶ Simplified accruals and realisation rules that limit their application to reduce spreading gains and losses, and simplify the calculations
- ▶ A new tax hedging regime which is easier to access, encompasses more types of risk management arrangements and removes the direct link to financial accounting
- ▶ Simplified rules relating to how foreign currency gains and losses are taxed.

It also confirmed that the Government would continue with previously announced measures that had not yet been legislated, which included:

- ▶ Amendments to tax hedging rules to ensure they operate as intended; and extending the range of entities that can use a functional currency (both announced in the 2011-12 Budget)
- ▶ Amendments relating to foreign currency regulations to provide technical and compliance cost savings measures (announced in the 2004-05 Mid-Year Economic and Fiscal Outlook).

BDO COMMENT

The purpose of these previously announced TOFA changes were to improve certainty and reduce compliance costs. BDO welcomes the deferral of the start date so that it aligns with the period in which the legislation is actually passed and taxpayers do not have to guess what the law might be. However, it is of grave concern that the Government has not yet legislated these previous announcements, where the whole purpose of the new provisions is to simplify the tax system. This speaks to a lack of resources in the Treasury Department that needs to be addressed.



SKILL SHORTAGES AT A TIME OF A STRONGER ECONOMY AND LOWER UNEMPLOYMENT

With the ongoing growth in demand for temporary and permanent entry to Australia, in 2018-19 the Department of Home Affairs will administer revenue from Visa Application Charges of over \$2 billion, an increase of almost \$400 million over the previous year. With over 30,000 visa applications being lodged with the Department each day, the focus is on protecting and managing Australia's borders.

This is reflected in the 'Keeping Australian Safe' announcement, which includes strengthening airport security, improving the national security architecture, and continuing Operation Sovereign Borders to combat the threat of people smugglers. The establishment of the Home Affairs Portfolio reflects a whole-of-government approach to national security, law enforcement and functions related to the border.

Yet, the average staffing levels increase of 474 for 2018-19, is a modest increase over the previous year, and at the time of significant demand for temporary and permanent employer sponsored visas and processing delays across all visa programmes.

Skilling Australians Fund

The Migration Amendment (Skilling Australians Fund) Bill 2017 and the associated Migration (Skilling Australians Fund) Charges Bill 2017 passed the Senate on 8 May 2018.

It will come into effect once the Migration Regulations are passed. It will introduce the training levy for the new Temporary Skill Shortage (TSS) subclass 482 Visa (which replaced the Temporary Work (Skilled) subclass 457 Visa) on 18 March 2018 and the permanent employer – sponsored visas.

Over the forward estimates to 2020–2021, the Skilling Fund is budgeted to raise \$1.2 billion in revenue.

Religious institutions are the only organisations which will be exempt from the levy.

The Government will expand refund provisions to allow refunds of the levy in limited scenarios including where the visa application is refused on health or character grounds, the visa holder does not commence work with the employer, or the subclass 482 visa holder leaves their employer within the first 12 months of employment.

Reduction in visas for foreign doctors

The number of General Practitioners brought to Australia on visas each year will be reduced from 2,300 to 2,100 with savings in Medicare costs of \$400 million. The Government will also improve the targeting of visas for areas with doctor shortages, including regional areas.

Newstart and other welfare benefits

Migrants will not be eligible to access Newstart and other welfare benefits until they have lived in Australia for four years, providing a saving of \$200 million.

Building Australia and a stronger and smarter economy

The Budget includes a range of measures for a stronger economy with government investment in essential infrastructure and to build the industries and jobs which Australia needs to compete globally.

Against this economic outlook, the Skilling Australians Fund Bill was amended to require significant administrative actions by employers. While labour market testing does not apply if it would be inconsistent with Australia's international trade

obligations, there is nothing in the Budget to better enable Australian businesses to meet targeted skill shortages at a time of a stronger economy.

BDO COMMENT

Business will continue to carry unnecessary burdens when looking for skilled labour, due in part to the Skilling Australians Fund levy.

It is also anticipated that there will continue to be significant processing delays in regard to temporary and permanent entry employer sponsored visas given the Department's resource constraints and focus on protecting Australian jobs.





INTEGRITY MEASURES

EXTENSION OF GST – OFFSHORE SUPPLIERS OF HOTEL ACCOMMODATION

From 1 July 2019, offshore suppliers of hotel accommodation in Australia will be required to include these sales when calculating their GST turnover.

Current Law

Based on the wording of the current law, non-resident suppliers of Australian hotel accommodation are not generally required to register for GST. This is on the basis their supplies of rights to accommodation in Australia are excluded in determining whether the \$75,000 turnover threshold is satisfied.

This means that these offshore operators do not impose GST on their supplies of Australian hotel accommodation.

Proposed amendments to the law

In order to amend the GST legislation, unanimous agreement of the States and Territories will be required. There is no guidance as to how the law will be amended, however, BDO considers this will involve alterations to the provisions dealing with the calculation of GST turnover.

Impact

The proposed change will mean that foreign suppliers of Australian hotel accommodation will now likely need to include the value of these supplies in calculating their GST turnover.

This will mean foreign operators will be in the same GST position as local providers of hotel accommodation.

BDO COMMENT

Previous changes to the GST law have seen cross-border supplies of digital products and services to Australian consumers brought within the GST net. Along with the taxation of low value goods from 1 July 2018, the proposal to extend GST to offshore supplies of Australian hotel accommodation is unsurprising.

Based on recent observations, we note that enforcing these laws will be challenging and complex. Initially, the bulk of enforcement activity will be targeted at large players. However, given the lead time for implementation, large overseas providers will have an opportunity to consider the impact of these changes and update their systems and processes accordingly.

DIVISION 7A AND UNPAID PRESENT ENTITLEMENTS

The 2016 Federal Budget heralded the Government's intention to make targeted improvements to the operation and administration of Division 7A of the ITAA 1936. Two years later, no legislation has been forthcoming, but an additional measure to deal with Unpaid Present Entitlements (UPEs) has been announced.

UPEs arise where a related private company is entitled to a share of trust income as a beneficiary, but has not been paid that amount.

Division 7A is an integrity rule that requires both cash and non-cash benefits provided by private companies to related taxpayers to be taxed as dividends unless structured as Division 7A complying loans.

From 1 July 2019, UPEs will fall within the scope of Division 7A rather than the current concessional treatment allowed under the ATO's practice statements. This concessional treatment defers the payment of UPE itself to the end of the term of the agreement, rather than an annual repayment obligation that is required under Division 7A. Annual interest repayments are required under both arrangements.

Where UPEs have not been paid due to the funds being re-invested in income generating assets or businesses, this change is likely to have a real cash flow impact due to the change in timing of principal repayments.

BDO COMMENT

Any measure aimed at simplifying an already complex area of tax legislation is always welcomed. However, continual delays in releasing any details on these reforms, means that uncertainty increases for private companies and their associated entities. Given that the changes will result in real cash flow adjustments, taxpayers need to understand these changes early to enable them to plan and adjust cash flow projections accordingly.

MANAGED INVESTMENT TRUSTS

In the 2018-19 Federal Budget, the Government announced that Managed Investment Trusts (MITs) will be prevented from applying the capital gains discount at the trust level. Additionally, new jurisdictions have been added to the list of information exchange countries, which means residents in these jurisdictions will be eligible to access the reduced MIT withholding tax rate of 15%.

MIT withholding tax

Currently, MITs are required to withhold a final withholding tax of 15% from fund payments made to non-Australian members who are resident in listed information exchange countries, or 30% if payment is made to a non-resident in a non-listed information exchange country.

The list of information exchange countries will be updated from 1 January 2019, to include 56 new jurisdictions, allowing residents in these countries to gain access to the reduced MIT withholding tax rate of 15%.

Removal of the capital gains discount

Broadly, a MIT or Attribution MIT's (AMITs) fund payment consists of the net Australian-sourced income, including capital gains from Australian sources. Where the MIT or AMIT has made a capital treatment election, its net income may include capital gains eligible for the 50% discount. As such, the fund payment amount on which withholding tax is applied is post the capital gains discount.

From 1 July 2019, it is proposed that MITs and AMITs will no longer be eligible to apply the 50% capital gains discount at its own trust level. The net capital gains income of the MIT and AMIT will correspondingly be doubled and, as such, the fund payment and withholding tax will also be doubled.

This change will only affect non-resident members of the MIT or AMIT. The capital gains will continue to be discountable in the hands of any Australian resident beneficiaries.

BDO COMMENT

This measure brings the MIT withholding regime in line with the Government's recent measures taxing non-resident property holders, which included the removal of the capital gains discount for non-Australian tax residents. This imposes a higher final withholding tax amount and prevents non-resident beneficiaries who are not entitled to the capital gains discount in their own right from benefiting from the discount at the trust level.

Whether it acts as a disincentive for foreign investors remains to be seen.



THE ATO IS COMING FOR TAX AND SUPERANNUATION DEBTS

In this Budget, the Government has announced that it will provide an additional \$133.7m to the ATO to address the levels of unpaid tax and superannuation debts in the community. It is intended to target taxpayers gaining an unfair financial advantage by not paying these amounts over those paying their fair share.

This measure is projected to have a gain to the Budget of \$1.2b over the four year forward estimate period.

BDO COMMENT

Taxpayers who have not prioritised paying their tax and superannuation debts in the past should expect to receive more attention from the ATO. The Government wants taxpayers to understand that the ATO is not a credit facility, and an increase in debt collection pressure by the ATO will likely reinforce this.

CRACKDOWN ON AUSTRALIA'S BLACK ECONOMY

The Government has taken on Australia's 'black economy' by proposing four new measures in an effort to improve the integrity of the Australian tax system.

Expansion of the taxable payments reporting system

The Government's taxable payments reporting system (TPRS) has been extended to the following industries:

- ▶ Security providers and investigation services
- ▶ Road freight transport
- ▶ Computer system design and related services.

The measures were previously applied to the building and construction, cleaning and courier industries, where the Government identified these industries as being at a higher risk of not complying with their tax obligations.

Businesses in the identified industries will be required to report contractor payments to the ATO, bringing the reporting of such payments in line with wages.

These measures are proposed to apply from 1 July 2019, with the first annual report required to be lodged in August 2020. The Government has promised a new online form, with the aim of making the reporting process smoother.

Introduction of cash payment limit

Off the back of the findings from the *Black Economy Taskforce*, the Government will introduce a limit of \$10,000 for cash payments made to businesses for goods and services from 1 July 2019. Notably, the Government appears to have carved out transactions with:

- ▶ Financial institutions
- ▶ Consumer-to-consumer non-business transactions.

We expect the Government to consult further on the details of these measures. It is reported that large undocumented cash payments are currently being used to avoid tax and/or launder money from criminal activity. These measures will require transactions over the \$10,000 threshold to be made through an electronic payment system or via cheque.

Tax deductibility of non-compliant payments

In an effort to create a further financial disincentive for businesses to engage in black economy behaviour, businesses will no longer be able to claim a deduction for payments made to their employees where they have not withheld the requisite PAYG under the proposed budget measures.

Further, the Government also proposes to remove deductions for payments made by businesses to contractors, where the contractor does not provide an Australian Business Number and the business does not withhold any amount of PAYG (as required).

The measures are proposed to apply from 1 July 2019.

Enhanced Government enforcement

To combat the measures outlined above, the Government will provide funding of \$318.5 million to the ATO over four years. These funds will be used to:

- ▶ Implement new mobile strike teams
- ▶ Increase audit presence
- ▶ Introduce a Black Economy Hotline designed to allow the community to report black economy and illegal phoenix activities
- ▶ Improve Government data analytics
- ▶ Develop educational activities around the black economy.

This funding will replace the terminating program which ceases on 30 June 2018.

BDO COMMENT

BDO acknowledges that the black economy imposes significant costs to Australia and, in particular, on honest businesses and individuals. However, we hope to see the Government's implementation of its proposed measures to ensure that they do not impose significant new compliance burdens on honest businesses, in order to capture the cheats.

Businesses who are engaging in the black economy should be on edge, given the significant funding that has been allocated to combating such behaviour.

ILLEGAL PHOENIXING GETS SNUFFED OUT

The Government continues to target illegal phoenixing arrangements where a new company is established to continue the business of another entity that was liquidated to avoid paying its liabilities. Phoenixing has a negative effect on the economy at large through increased costs to regulators and a loss of tax revenue, and at an individual level through the avoidance of employee entitlements including wages, superannuation, and accrued leave.

Legislative toolkit

The Government intends to extend the current anti-phoenixing provisions within the corporations and tax laws, and includes reforms to:

- ▶ Introduce new phoenix offences to target those who conduct or facilitate illegal phoenixing
- ▶ Prevent directors improperly backdating resignations to avoid liability or prosecution
- ▶ Limit the ability of directors to resign when this would leave the company with no directors
- ▶ Restrict the ability of related creditors to vote on the appointment, removal or replacement of an external administrator
- ▶ Extend the Director Penalty Regime to GST, luxury car tax and wine equalisation tax, making directors personally liable for the company's debts
- ▶ Expand the ATO's power to retain refunds where there are outstanding tax lodgements.

These reforms act in concert with the Government's Phoenix, Serious Financial Crime and Black Economy taskforces, and other announced reforms such as a Director Identification Number, and a combined black economy and illegal phoenixing hotline.

There is no revenue impact to the Commonwealth as the amounts collected under these measures are paid to the States. Notwithstanding the Director Penalty Regime is slated to raise \$40.0 million over the forward estimates.

BDO COMMENT

BDO acknowledges that there are loopholes in the current system allowing phoenix operators to gain unfair advantage over honest competing businesses. However, crucial to the effectiveness of the proposed reforms is to ensure they target illegitimate phoenix activities without jeopardising legitimate business behaviour. The proposed reforms present a welcome change in direction from reactive to proactive measures, with a view to deterrence.

ADDRESSING TAX RISKS OF STAPLED STRUCTURES AND LIMITING FOREIGN INVESTOR CONCESSIONS

Rehashing an earlier press release on 27 March 2018, the Budget reiterates a package of integrity measures directed at stapled structures and similar arrangements. The proposals address the perceived risks to the corporate tax base, due to the potential exploitation of these arrangements and limit concessions currently available to foreign investors.

The key elements of the package and their effective dates are detailed below. For those measures commencing from 1 July 2019, transitional provisions will apply such that if an arrangement is already in place as at 27 March 2018, the measures will not apply to the arrangement until 1 July 2026.

Prevent trading income from being taxed at the MIT withholding tax rate of 15%

It is proposed that, from 1 July 2019, a final withholding tax at the general corporate tax (currently at 30%), rather than the concessional Managed Investment Trust (MIT) withholding tax rate of 15%, be applied to distributions of trading income that has been

converted to passive income using a MIT, with the exception of rent derived from third parties.

However, new Government-approved stapled structures for nationally significant infrastructure are eligible for a 15-year exemption from this measure.

Reduce the associate entity threshold under the thin capitalisation rules from 50% to 10%

From 1 July 2018, the thin capitalisation associate entity test will be modified such that any interest of 10% or more in a flow-through entity (ie, partnerships and trusts) will be treated as an associate entity interest, which is aimed at preventing foreign investors from using multi-layered structures to convert trading income into more favourably taxed interest income.

Limit the withholding tax exemption for foreign pension funds on interest and dividends to portfolio investments

From 1 July 2019, any interest and dividend income derived by foreign pension funds from non-portfolio investments (ie, an ownership interest of less than 10% interest) will be subject to non-resident withholding tax. At present, foreign pension funds that are exempt from income tax in their country of residence are exempt from the withholding tax.

Limit the tax exemption for foreign governments to income from portfolio investments

As a general administrative practice, Australia currently provides a limited tax exemption on income derived by foreign governments (including sovereign wealth funds) that are investing in Australia in a non-commercial capacity. This measure proposes to create a legislative framework that will remove the tax exemption from non-portfolio investments from 1 July 2019.

Remove access from agricultural land investments to the MIT withholding tax rate of 15%

This measure proposes to remove rent derived from agricultural land from being qualified as income from an 'eligible investment business', which effectively means that such rent will no longer be eligible for the concessional MIT withholding tax rate of 15% from 1 July 2019.

BDO COMMENT

The fact that these measures are all under the common heading 'Stapled structures – tightening concessions for foreign investors' can be misleading – the measures go beyond addressing issues associated with stapled structures.

The 'losers' of these measures are foreign investors who would otherwise be eligible for the concessional MIT withholding tax rate of 15% on a number of investment fronts. This package may prove to be a tricky move as eroding these tax concessions may discourage foreign investments in Australia, which may have a knock-on effect on the wider economy.

The changes to the thin capitalisation rules may affect existing investors who already have financing structures in place and find themselves denied tax deductions on interest and other debt deductions under the new rules. Given that these rules will come into effect in less than 2 months' time without any transitional concessions, those affected will need to assess how they may be impacted within a very short time frame and respond accordingly.

HOLDING VACANT LAND TO BECOME MORE EXPENSIVE

The Government is targeting taxpayers that engage in land banking or hold vacant land by denying a deduction for any costs in holding that land.

The Government has announced that anyone carrying on a business will be exempted from this proposed law. However, anyone passively holding vacant land for the development of future rental properties from 1 July 2019 will face the denial of deductions for holding costs.

Timing of deductions

Under the Budget announcement, the Government is proposing that any tax deductions for holding vacant land will be denied until the following conditions are met:

- ▶ A property is constructed on the land
- ▶ Regulatory approval has been received to occupy the property
- ▶ The property is available for rent.

However, costs that are not deductible before the above criteria have been met, are able to be added to the cost base of the property to reduce any future capital gain, where they would normally form part of the cost base.

Primary producers to be exempt

Owners that acquire land for use in a primary production business will be exempted from this measure.

BDO COMMENT

At first glance, the Government's proposal appears to legislate against the outcome in a seminal High Court decision, and will eliminate negative gearing benefits in the early years of a build to rent development.

The denial of deductions for a future revenue generating asset repeals a core principal of the tax legislation and will force future investors to have greater access to capital before engaging in these types of developments. This appears to be another attempt to improve housing affordability by forcing land owners to either develop additional housing on these vacant blocks, or make it uneconomical to hold the land.

CGT CHANGES FOR PARTNERS

The small business capital gains tax (CGT) concessions for partners in partnerships will be eliminated in certain circumstances.

Partners in a partnership have the ability to transfer the rights to their future income from the partnership to other entities, effectively reducing the income tax liability of the partner assigning the right. The assignment would usually be to a lower tax paying entity. When these rights are assigned, the small business CGT concessions would typically be available to reduce the capital gain on the disposal. This will no longer be possible under the proposed measure.

There are no amendments to the concessions themselves. Eligible small businesses will continue to have access to the concessions.

BDO COMMENT

This measure appears to be directed at large professional partnerships seeking to manipulate the concessions that are otherwise intended to reduce the tax burden for genuine small businesses. BDO expects to see legal, accounting, engineering, medical and other professional firms to be under increased scrutiny and investigation by the ATO in relation to their tax affairs.

IMPACTS FOR TRUSTS

The Government has implemented three tax integrity measures to improve the taxation of trusts:

- ▶ Extending anti-avoidance rules for circular trust distributions
- ▶ Improving the taxation of testamentary trusts
- ▶ Removing the capital gains discount at the trust level for Managed Investment Trusts (MITs) and Attribution MITs (AMITs).

Circular trust distributions

The Government has extended a specific anti-avoidance rule that applies to closely held trusts engaging in circular trust distributions to also include family trusts. Currently, family trusts acting as beneficiaries of one another are able to distribute in a 'round robin' manner, which results in the distribution ultimately returning to the original trustee without any tax being paid on the 'circular distribution'.

By extending the specific anti-avoidance rule from 1 July 2019, the ATO will be able to more effectively pursue family trusts exploiting this by imposing tax on such distributions at the top personal tax rate, plus the Medicare levy. This measure is estimated to have a gain to revenue of \$20 million over the next four years.



Real reform	3200
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Exploitation of testamentary trusts

Under new measures, taxpayers will be prevented from exploiting testamentary trusts by injecting assets unrelated to the deceased estate into the testamentary trust. Currently, income distributed from testamentary trusts to minors is taxed at normal adult rates rather than the higher tax rates that apply to minors.

From 1 July 2019, the concessional tax rates available for minors will only apply to income derived from assets that are transferred from the deceased estate or proceed from the disposal or investment of those assets.

BDO COMMENT

The new anti-avoidance rules terminate some aggressive tax planning approaches. The question is whether the existing powers of the ATO would have been sufficient to deal with these matters, without adding more pages to the already overflowing tax law.

HIGH PROFILE INDIVIDUALS

The Government has announced that, from 1 July 2019, income from the commercial use of an individual's fame or profile must be attributed to that individual and included in their personal income.

Currently, high profile individuals such as sports people and actors are able to licence out their fame or profile to a related company or trust which in turn receives the income for the use of their image by third parties. The income derived from the commercial use of an individual's fame is considered to be business income and therefore individuals can take advantage of different corporate structures and potentially lower tax rates.

The proposed measure in the 2018-19 Budget means that all remuneration (cash and non-cash benefits) received for the use of an individual's fame or profile, must be included in that individual's assessable income and taxed at their marginal tax rates. Income will no longer be able to be diverted to a company or beneficiaries of a trust. This will mean that high profile individuals are likely to pay higher taxes.

BDO COMMENT

This integrity measure aims to reduce income diversion as a way for high profile individuals to manipulate and minimise their taxable income. From 1 July 2019, income derived from the commercial use of an individual's fame will be treated in the same way as personal services income and must be included in their assessable income. BDO expects this to have a significant impact on sports people, as they have previously received rulings allowing them to divert up to 20% of their income by licencing out their fame and profile.

THIN CAPITALISATION CHANGES

Tightening of the thin capitalisation rules is one of the Government's key international tax integrity measures included in this year's Budget. The thin capitalisation provisions deny interest deductions to entities where they are either foreign owned, or own a foreign entity, and the legislation deems them to be insufficiently capitalised.

In order to increase the denial of interest deductions to Australian entities, the valuation methodology relating to assets will be restricted and potential tax advantages for consolidated groups and multiple entry consolidated groups with a foreign entity will be eliminated.

Existing ATO guidance allows entities to value assets and liabilities in accordance with accounting standards, even if these disclosures are not included in the entities' formal accounts. Consequently, entities may value assets at market value regardless of the disclosures made in the entity's financial statements. The proposed change will ensure that assets may only be valued in accordance with the financial statement disclosures.

Currently, consolidated groups and multiple entry consolidated groups that are both controlled by a foreign entity and control a foreign entity may have access to concessional treatment available to outward investor entities. This can exclude the consolidated group from the thin capitalisation regime where the Australian asset threshold is met. By contrast, under the general thin capitalisation provisions, this concession is excluded where an entity qualifies as both an outbound and inbound investment vehicle. The announced change seeks to align the treatment of consolidated groups and multiple entry consolidated groups with those applying to other entities under the general thin capitalisation provisions.

BDO COMMENT

These rules further reduce the scope for entities to gain advantages under the thin capitalisation provisions. It continues the Government's focus on the level of Australian tax payable by multinational enterprises.

