2019 BUDGET UPDATE

PERPETUAL CORPORATE TRUST

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2019 FEDERAL BUDGET UPDATE

The Federal Budget was handed down in May, and while the headline focus has been on income tax cuts for Australian workers, there are several other announcements that may be of interest to global and domestic investment managers.

MORE FOREIGN INVESTORS CAN NOW ACCESS MIT TAX CONCESSIONS

A key benefit of a Managed Investment Trust (MIT) is that investors are able to access a reduced rate of withholding tax. But for some foreign investors, accessing this benefit can be difficult as it's only accessible from MITs or AMITs if their home country has an agreement with Australia that offers an effective 'exchange of tax information'.

Good news, from 1 January 2019 there will be a further 56 jurisdictions added to the list that are recognised as having a suitable tax information sharing policy. This greatly increases the chances that a foreign investor will be able to access concessional MIT withholding tax rates.

STAPLED STRUCTURES INTEGRITY MEASURES

Stapled structures are those which combine one or more entities that are commonly owned, such that they cannot be bought or sold separately—with one entity being a trust. The most recent budget has handed down a package of stapled structures integrity measures that affect the tax treatment of agricultural land within these structures.

As they stand, the measures no longer allow agricultural land, held in an MIT, to access the 15 per cent concessional withholding tax rate.

MORE CHANGES TO 'THIN CAPITALISATION' RULES

Tightening of 'thin capitalisation' rules will require companies to align the value of their assets with those in their financial statements in relation to debt financing. The rules come into effect on 1 July 2019, with valuations made prior to the budget announcement being relied upon in the interim.

A further change will ensure that inbound investors cannot take advantage of tests that were only intended for outward investors. Foreign controlled Australian companies, that control a foreign entity, will be treated as both outward and inward investment vehicles for thin capitalisation purposes.

CHANGES IN CAPITAL GAINS TAX FLOW-THROUGH TREATMENT

In the past, MITs and AMITs have been able to access the capital gains tax discount of 50% on the sale of assets held for more than 12 months. From the beginning of July 2019 this capital gain will need to be 'flowed through' as distributable income to beneficiaries. The discount will no longer be applied at a trust level.

This measure prevents investors who would not be entitled to the CGT discount had they invested directly, from getting a benefit from the CGT discount being applied at the trust level.

VACANT LAND EXPENSE DEDUCTIONS NO LONGER ALLOWED

Landlords with vacant land will now be incentivised to develop it, as tax deductions for expenses on the land will no longer be available from July 2019.

Whilst denied deductions will not be able to be carried forward for use in later income years, expenses that would ordinarily be counted towards the cost base (such as borrowing expenses and council rates) can be included in the cost base of the asset for capital gains tax purposes when the land is sold.

Expenses incurred will be deductable once development is completed and the property is available for rent or is being used by the owner to run a business.

And if planning approval for development is delayed, there is no exemption from the denial of deductions.

BROADENING THE 'SIGNIFICANT GLOBAL ENTITY' DEFINITION

The definition of a 'Significant Global Entity' (SGE) will be broadened to ensure Australia's multinational tax integrity rules operate as intended. The categorisation will now include members of large multinational groups headed by private companies, trusts and partnerships and members of groups headed by investment entities.

SGES are subject to Australia's multi-national tax integrity rules, including the Multinational Anti-Avoidance Law and Diverted Profits Tax.

We recommend investors consider whether they will now fall within the new definition of an SGE, and assess their compliance obligations, in relation to financial reporting and tax lodgements.

IMPROVED ECONOMIC OUTLOOK

The budget has heralded a positive economic outlook for Australia going forward.

Annual growth is expected to remain in a tight band between 2.7% and 3.1% from FY18 through to FY21.

Inflation is projected to stay within the Reserve Bank of Australia's target range of 2.0% to 3.0%. The unemployment rate looks set to head lower, from 5.3% in 2018 to 5.0% in 2021.

Generally, commentators have suggested that these forecasts are conservative.

INFRASTRUCTURE SPENDING GOING UP

Investors that are interested in gaining additional exposure to Australian infrastructure assets should note the budget has made a significant commitment of $24.5 billion to new infrastructure projects across Australia.

Some major plans include:

- $5 billion towards a rail link between Melbourne CBD and Melbourne Airport
- $3.5 billion to a 'Roads of Strategic Importance' initiative, targeted at upgrading major freight routes to improve access to export industries
- $1 billion commitment to development of an 'Urban Congestion Fund', and
- $2.2 billion to be provided under the Assets Recycling Program to New South Wales, the Northern Territory and Australian Capital Territory.

MISSED OPPORTUNITIES

We had hoped that the pending implementation of Corporate Collective Investment Vehicles and the Asia Regions Funds Passport, would entice the Australian government to announce measures that simplify and streamline withholding tax arrangements for foreign investors.

NEXT STEPS

With so many changes afoot it's more important than ever that you seek specialist tax or legal advice in relation to understanding how these measures will affect your existing arrangements for holding investments in Australia.

Alternatively, please contact your Corporate Client Manager should you require further information.