AUSTRALIAN FEDERAL BUDGET 2023-2024 - KEY TAX MEASURES AND INSTANT INSIGHTS

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Australia Tax Alert

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The Australian Federal Government has just released its budget for 2023-24. The K&L Gates tax team outlines the key announced tax measures and our instant insights into what they mean for you in practice.

Key Announced Tax Measures	K&L Gates Instant Insights
Build to Rent (BTR) Managed Investment Trust (MIT) withholding tax reduction - a reduction in withholding tax for foreign investors from 30% to 15% on distributions from eligible residential BTR projects, starting 1 July 2024. Eligibility criteria still to be determined, but likely to focus on minimum levels of affordable rental housing and minimum ownership periods (such as 10 years for the depreciation changes below).	▪ Potentially unlocks significant offshore capital for investment into the residential BTR sector - allowing foreign capital to partner willing Australian capital (e.g. super funds) that has been looking to de-risk. ▪ Evens up the treatment with commercial real estate investment, making it easier to compete for BTR capital. ▪ Key issue will be the eligibility criteria, and whether the Government can resist casting it too narrowly to actually be effective.
BTR accelerated capital works deduction - an increase in the rate of capital works deductions (i.e. depreciation of construction costs) from 2.5% to 4%, for construction commencing after 9 May 2023. Applies to buildings with 50 apartments/dwellings, with leases of a minimum term of three years, and single ownership of project for 10 years.	▪ BTR projects will be able to make higher early-stage tax-free returns of capital to investors (allowing it to be reinvested or reallocated). ▪ May also support greater debt capacity through improved cashflows / reduced tax leakage (although this is tempered by the debt deduction limitations discussed below). Again, this may help to unlock capital for the BTR sector.
Clean building MIT withholding tax concession	▪ This is billed as a clean energy measure,

extended to energy efficient data centres and warehouses - this reduces the existing MIT withholding tax rate from 15% to 10% for clean buildings that are data centres/warehouses.	but will deliver very attractive withholding tax rates for foreign capital investing in data centres and warehouses that meet minimum energy efficiency requirements (including below the rate offered to BTR), and so may see greater foreign investment in this type of infrastructure.
Implementation of global minimum tax - Australia will implement the Organisation for Economic Co-operation and Development Pillar 2 Global Anti-Base Erosion Rules 15% 'global minimum tax' from 1 January 2024. This affects groups with global accounting revenue of ~AU$1.2 billion (€750 million) or more, and broadly comprises: ▪ Income Inclusion Rule (IIR), so Australian parent companies will be subject to 'top up tax' on accounting profits in jurisdictions with a less than 15% effective tax rate on broadly accounting profits in that jurisdiction. ▪ 15% Qualifying Domestic Minimum Top-Up Tax (QMDTT), where Australian accounting profits are subject to a less than 15% effective tax rate. ▪ Undertaxed Payments Rule, which seeks to apply top up tax (to 15%) on accounting profits where no IIR in parent jurisdiction and no QMDTT - i.e. to make sure profits are taxed at a minimum of 15% by some jurisdiction to apply from 1 January 2025. ▪ Australian headquartered groups required to lodge annual return covering jurisdiction-by-jurisdiction global profits, tax rates and other information.	▪ Targeted at large multinational groups and follows implementation by other countries (United Kingdom, the European Union, Canada, Singapore etc.) ▪ Represents a ***massive*** compliance challenge for multinationals, irrespective of whether they will incur further tax - they will have to calculate the 'effective tax rate' jurisdiction-by-jurisdiction and file a return with the Australian Taxation Office (ATO) even if no tax. ▪ On the tax itself, multinational groups will need to review their global operations and work out where, if it all, they may have accounting profits taxed at <15%. ▪ Australian headquartered groups will also need to pay a top up tax in Australia under the IIR for accounting profits in jurisdictions with <15% effective tax. However, QMDTT is unlikely to have significant application to Australian operations due to the high tax rates (although entities with tax credit shelters will need to consider their position carefully). ▪ Whilst it may either collect some modest additional tax and/or prompt other traditionally 'low-tax' jurisdictions to impose local tax, given the beneficial treatment of certain tax credits (which mean they don't reduce the effective tax rate) it is likely we will see jurisdictions

	moving to implement tax credit arrangements to provide a less than 15% effective tax rate.
Expansion of Part IVA anti-avoidance rules to foreign residents reducing Australian withholding tax or reducing foreign tax - expansion of the Part IVA rules to cover foreign residents entering into schemes to reduce Australian withholding tax and to schemes with a purpose of reducing foreign tax (that also reduce Australian tax).	▪ This will be an important consideration for foreign investors and multinationals going forward. ▪ Query whether we will see the ATO applying the rule to attack structures that use debt rather than equity to access lower tax rates. ▪ The extension of the anti-avoidance regime to schemes that result in a lower rate of withholding tax (rather than just avoidance of withholding tax, which is already subject to the anti-avoidance rules) has presumably resulted from schemes of the sort flagged by the ATO in Taxpayer Alert TA 2022/2: treaty shopping arrangements, where an entity is established in a favourable treaty jurisdiction and inserted between an Australian dividend or royalty payer and the ultimate recipient, to take advantage of a lower treaty withholding tax rate.
Petroleum Resource Rent Tax changes to bring forward LNG tax revenue: ▪ For offshore liquefied natural gas (LNG), changes to the 'super profits' tax to bring forward revenue by (a) after seven years, limiting deductions to 90% of revenue, (b) reducing the way carried forward deductions are annually 'indexed' from ~8.4% per annum to ~3.4% per annum (based on current bond rates, but variable over time) and (c) limiting allocations of losses to upstream extraction. ▪ More broadly, introducing updated anti-	▪ Mainly affects a small number of offshore LNG operations in Western Australia and the Northern Territory. ▪ Brings forward tax revenue not expected to be paid until mid-2030's. ▪ No longer a 'super profits' tax - although the 90% limit on deductions and reduced indexation appear to have been the 'least worst' outcome for the LNG industry (which appears to have accepted the changes) and are softened by a seven-year grace period, it is much more likely to capture what might be considered the 'ordinary profits'.

avoidance rules, allowing the ATO to have greater discretion over whether multiple fields are considered one project or multiple projects, introducing limitations on initial exploration deductions (backdated to 2013) and introducing administrative efficiencies.	▪ Moreover, the focus on LNG continues following moves on caps on gas pricing, flagged costs for carbon abatement, difficulties in project approvals etc.
Confirming tougher restrictions on debt deductions - no substantive updates on the already announced restrictions to debt deductions that will commence from 1 July 2023, despite the rapidly approaching commencement - as a reminder, the key measures include: ▪ Net debt deductions limited to 30% tax earnings before interest, taxes, depreciation, and amortization. ▪ Arm's length debt test limited to third party debt, and requires election and satisfaction of strict criteria to apply. ▪ Requirement to demonstrate debt levels (not just interest rate) are consistent with arm's length amounts for transfer pricing purposes. ▪ Removal of deduction for interest used to fund foreign branches/subsidiaries. ▪ Not applicable to financial entities (i.e. banks).	▪ Represents substantial overhaul and tightening of the rules on interest deductibility - and with no transition and still no final legislation or updates in the budget before commencement on 1 July 2023, it is also extremely difficult for groups to plan - but groups will need to be ready to act quickly. ▪ There will be plenty of groups experiencing significant denied interest deductions based on structures set up well before the current rules were contemplated (and relying on the old supposed 'safe harbour' provisions). ▪ Groups subject to thin capitalization need to urgently review their debt portfolios and model potential denied deductions - particularly where they have been relying in the past on the arm's length rule. ▪ There are particular implications for naturally high debt industries (real estate, infrastructure etc.) as well as for structures involving multiple layers of trusts, where the new rules can have significant impacts that can affect the anticipated commercial returns. ▪ The requirement to transfer price debt quantum (and just not rates) also means needing to support cross-border debt by a detailed transfer pricing study.
No update on corporate tax residency changes -	▪ Very disappointing that no update was

there has been no update on the previously proposed changes to corporate tax residency under which foreign companies would only be an Australian tax resident if their core commercial activities were in Australia AND central management and control was in Australia.	provided, particularly given the ATO will remove its COVID-19 inspired administrative concessions designed to prevent inadvertent residency and the ATO's continuing position on residency (where they consider the central management and control is taken to be carrying on a business).
Confirming denial of deductions for payments relating to intangibles to low tax jurisdictions - no update on measures to deny deductions for payments made to associates attributable to an arrangement involving the acquisition or right to use an intangible asset (defined broadly) made to a low tax jurisdiction (tax rate of less than 15%). Only applies to significant global entities' (SGE) (global group turnover of AU$1 billion+).	▪ Targeted at SGEs but a very broad measure that goes well beyond traditional definition of royalty payments (including covering broader arrangements which do not directly relate to intangible payments). ▪ SGEs will need to carefully consider any offshore low tax jurisdictions which are receiving intangible related payments. ▪ Although badged as an integrity measure, there is also no requirement for a purpose to obtain a tax advantage.
Abandonment of patent box measures previously announced - the previous Federal Government had announced a patent box regime to support medical and biotech sectors with a concessional tax rate, but the current Government has announced it is not proceeding with the measure.	▪ Patent boxes are widely used in Europe to incentivize in-country research, with the reduced tax rates provided under the patent box regimes ranging from 0% to 12.5%. ▪ Australia's research and development tax credit regime is competitive globally but is not leading edge and so the expectation was that the patent box regime would make Australia a more compelling destination for locating investment in science and innovation. It is disappointing that this initiative is not being progressed.
Small business incentive for expenditure on electrification - small-and-medium-sized businesses, with an aggregated annual -turnover of less than AU$50 million, which spend on	▪ Reduces effective cost of electrification of assets for small business, including upgrades and installation of heating and cooling systems, energy efficient

electrification of assets and improvements will be able to access a 20% tax deduction up to AU$20,000.	appliances, batteries, and heat pumps. Small business will still need to find cash for upgrades in an uncertain economic environment. ▪ To be eligible, the relevant eligible electricity asset (or upgrade) will need to be first used (or installed ready for use) between 1 July 2023 and 30 June 2024.
Small businesses granted a temporary increase to instant asset write off threshold - the Federal Government will grant small businesses a temporary increase to the instant asset write-off threshold to AU$20,000. The measure will apply for assets first used or installed ready for use in the income year 1 July 2023 to 30 June 2024.	▪ Incentives for small businesses are always welcome, although query in the uncertain economic climate whether small businesses will be in a position to spend the money with or without the tax reduction.
Bringing forward payment of employer superannuation contributions - from 1 July 2026, employers will be required to pay employees' superannuation contributions at the same time as they pay salary and wages, rather than quarterly.	▪ This may have cashflow implications for businesses, particularly those struggling in the current environment - however superannuation was never intended to be a cashflow tool and so this is a welcome measure to ensure employees get paid superannuation on time.

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