client alert | explanatory memorandum

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CURRENCY:

This issue of **Client Alert** takes into account developments up to and including 25 January 2024.

Proposed changes to stage 3 tax cuts announced

With the government finally caving into pressure to change the stage 3 income tax cuts despite its previous promises to keep the already legislated measures, new proposed tax rates have been flagged to come into place from 1 July 2024, largely – in comparison to the legislated measures – benefiting those earning less than $45,000. The government will now be starting a campaign to win Parliamentary support for these proposed changes to ensure amending legislation is introduced and passed before 1 July 2024 (when the original stage 3 changes were due to apply).

The talk about the stage 3 income tax cuts has reached fever pitch in recent weeks. The changes were originally legislated by the previous Coalition government in 2019 with support of the then Labor opposition. During the 2022 election campaign and since coming into government, Prime Minister Anthony Albanese had reassured voters on multiple occasions that the stage 3 tax cuts would remain. However, with the recent inflationary stressors, the government has been under increasing pressure to scrap the already legislated tax cuts in favour of cost-of-living relief for low to middle income earners, which would require the introduction of amending legislation.

As a refresher, the original stage 3 tax cuts are due to come in place from 1 July 2024, and would benefit individuals that earn above $45,000 of taxable income.

Under the current (pre-stage 3) rates, individuals that earn between:

- $0 and $18,200 pay no tax;
- $18,201 and $45,000 are taxed at 19% of excess over $18,200;
- $45,001 and $120,000 are taxed at $5,092 plus 32.5% of excess over $45,000;
- $120,001 and $180,000 are taxed at $29,467 plus 37% of excess over $120,000; and
- $180,001 and more are taxed at $51,667 plus 45% of excess over $180,000.

From 1 July 2024, however, under the already legislated stage 3 tax measures, those earning taxable income between $45,000 and $200,000 will be taxed at $5,092 plus 30% of excess over $45,000. In addition, individuals who earn $200,001 and more will taxed at $51,592 plus 45% of excess over $200,000.

According to the latest ABS data, the median earnings of full-time Australian workers are around $1,600 per week, equating to $83,200 per year. Under the current rates a worker on this median wage would be paying $17,507 in tax, and under the already legislated stage 3 rates for the 2024–2025 income year the same worker would be paying $16,552 (a tax saving of $955).

Of course, as critics of the legislated tax cuts have pointed out, those who earn more will be saving more. For example, the same ABS data indicates that individuals earning $2,820 per week are in the 90th percentile of workers in Australia. This figure equates to annual earnings of $146,640. Under the current tax rates a worker on this wage would be paying around $39,323 in tax, and under the already legislated stage 3 tax rates the same worker would only be paying $35,584 (a tax saving of around $3,739).

This effect becomes even more pronounced at the edge of the stage 3 threshold of $200,000. As currently legislated these individuals would experience a tax saving of a whopping $9,075 ($60,667 in tax under the current rates versus $51,592 in 2024–2025 under the stage 3 tax cuts).

New proposals

Under the government’s most recent proposed changes, those earning between $18,201 and $45,000 would see their tax rate reduced from 19% to 16%. In addition, those who earn between $45,001 and $135,000 would be taxed at the new marginal tax rate of 30%, and the existing 37% marginal rate would be retained but would apply to individuals earning between $135,001 and $190,000. The top marginal rate of 45% would remain for those who earn $190,001 and above.

An average worker earning $83,200 per year will be better off under the government's proposed changes, paying around $15,748 in tax (versus $16,552 under stage 3 and $17,507 under the current rates), and those in the 90th percentile of earners would be slightly worse off under the proposed changes ($35,594 in tax) compared to stage 3 ($35,584 in tax), but would still be better off than under the current system ($39,323 in tax).

The government will now be working to get the proposed changes passed before 1 July 2024. It is widely speculated that the Coalition will largely vote against the change; however, it is likely that the proposed changes will still go through, given the previous verbal support for scrapping the stage 3 tax cuts from the Greens and some independent senators.

Medicare levy low-income threshold 2023–2024

The Prime Minister also flagged in his press release that the government will increase the Medicare levy low-income thresholds for 2023–2024. There are no details provided as to numbers, so it is not yet known whether the increase would be CPI-related (which is the standard approach), or perhaps be greater (as part of the "relief" plan).

Source: www.pm.gov.au/media/tax-cuts-help-australians-cost-living
https://treasury.gov.au/tax-cuts
https://treasury.gov.au/tax-cuts/treasury-advice

ATO areas of focus on businesses for the coming year

As we move into 2024, the ATO has highlighted three areas of focus for businesses: taking steps to address cyber security and increased protection of personal data, addressing the growth in the collectable debt book – particularly for small businesses – and improving overall tax performance and stamping out the shadow economy. The takeaway message for businesses, especially small businesses, for this year is to be proactive and engaged with the ATO in terms of any unpaid tax or super debts and keeping data secure.

With increased cyber-crimes, scams and hacks occurring in Australia in recent times, like any other large organisation the ATO has taken additional steps to address cyber security and increase protection of personal data to deal with an unprecedented rise in identity-related fraud attempts. For all businesses, the ATO has introduced "client-to-agent linking", which requires all entities with ABNs (excluding sole traders) to digitally nominate their agent through ATO's secure online services before the agent can access any data. This will cover approximately 4.7 million businesses and will only apply if businesses engage a new agent, change their existing agent, or want to provide additional authorisation for their existing agent.

For all individuals interacting with the tax system, the ATO encourages the use of myGovID. This coincides with the government announcing a tightening of the way in which individuals access their myGov account. Individuals who use their myGovID to access the ATO's services will need to use that myGovID for future logins from now on. In other words, it will not be possible to access an ATO account without it.

myGovID is an app that proves an individual's digital identity. Once set up, the app can be used to access government online services without having to prove identity or remember passwords. This can be used for personal or business services, although the myGovID must be linked to an ABN through the relationship authorisation manager to allow users to act on behalf of the business. Anyone aged over 15 years who has access to a smart device and has a personal email address can set up the service. Protecting the system and taxpayers against fraud will continue to be a key theme for the ATO.

In 2024, the ATO will also be seeking to address the growth in the collectable debt book. Currently, the collectable component of debt sits at about $50 billion and consists of mostly self-assessed debt, with small businesses owing 67% of this. This does not include disputed debt, which is treated separately. According to the ATO, during the pandemic it took a different audit position, chased fewer lodgments and recovered less debt. This has led to a concerning behavioural pattern from some businesses after the pandemic where they deprioritise paying tax and super and increasingly rely on unpaid tax and super to prop up cashflow.

While the ATO notes that it is seeking to engage with those businesses to help them understand and pay tax debts and employee super, it is also using its full arsenal to protect employees, clients and customers. One of the ways the ATO is seeking to level the playing field on uncooperative businesses is the reporting of debt information to credit reporting bureaus. Since 1 July 2023, it has disclosed the debts of more than 10,500 businesses that have significantly overdue undisputed tax debts of at least $100,000.

Staying on the topic of small businesses, the ATO will be seeking to improve tax performance in 2024. Even though the tax performance of small businesses is currently running at around 87%, the ATO notes that there is a small minority of dishonest businesses operating wholly or partly in the shadow economy that is contributing to the underperformance. To eliminate businesses operating in the shadow economy and reduce honest mistakes by small businesses, the ATO is seeking to build a digital-first ecosystem which will move tax reporting closer to the tax event and have seamless tax and reporting from business source to the ATO.

Employees versus contractors: new rules

Following two prominent High Court decisions which dealt with the distinction between employees and independent contractors, the ATO has sought to provide guidance to businesses in the form of a taxation ruling. The most significant departure from its previous position is that the ATO now considers that various indications of employment identified in case law, while relevant, should only be considered in respect of the legal rights and obligations between the parties, with the most important factor the holistic consideration of the contract between the parties.

Following on from two prominent High Court decisions in *Construction, Forestry, Maritime, Mining and Energy Union v Personnel Contracting Pty Ltd* [2022] HCA 1 and *ZG Operations Australia Pty Ltd v Jamsek* [2022] HCA 2, the ATO has issued Taxation Ruling TR 2023/4 *Income tax: pay as you go withholding – who is an employee?* clarifying the issue of whether certain individuals are employees or independent contractors.

In brief, the High Court's decisions deal with the distinction between employees and independent contractors in the context of a labour-hire company and two truck drivers operating through partnerships to provide delivery services to their former employer. In the first case, the High Court ruled that a labourer engaged by a labour-hire company to work on construction sites under the supervision and control of a builder was an employee of the labour-hire company.

The High Court noted that this right of control, and the ability to supply a compliant workforce, was the key asset of the business as a labour-hire agency and constituted an employment relationship. That the parties chose the label "contractor" to describe the labourer did not change the character of that relationship, the High Court said. This decision also overruled a earlier Full Federal Court decision which held, after applying a "multifactorial approach", that the labourer was an independent contractor.

In the second case, the High Court held that two truck drivers were not employees of a company for the purposes of the *Fair Work Act 2009* and *Superannuation Guarantee (Administration) Act 1992*. The Court also observed that the provision of such services has consistently been held, both in Australia and in England, to have been characteristic of independent contractors (and not of employees). In the present case, the High Court said there was no reason to reach a different conclusion.

The ATO's TR 2023/4 now states that whether an individual worker is an employee of an entity under the term's ordinary meaning is a question of fact to be determined by reference to an objective assessment of the totality of the relationship between the parties, having regard only to the legal rights and obligations which constitute that relationship.

In addition, where the worker and the engaging entity have comprehensively committed the terms of their relationship to a written contract and the validity of that contract has not been challenged as a sham, nor have the terms of the contract otherwise been varied, waived, discharged or the subject of an estoppel or any equitable, legal or statutory right or remedy, it is the *legal rights and obligations in the contract alone* that are relevant in determining whether the worker is an employee of an engaging entity.

The ruling notes that evidence of how the contract was performed, including subsequent conduct and work practices, cannot be considered for the purpose of determining the nature of the legal relationship between the parties. However, this evidence can be considered to establish the contractual terms or to challenge the validity of a written contract with general contract law principles.

It should be noted that the ruling states that the various indicators of employment that have been identified in case law (that is, control and right to control; ability to delegate, subcontract or assign work; achievement of a specified result; being the bearer of risk; or generation of goodwill) remain relevant, but are only to be considered in respect of the legal rights and obligations between the parties.

Therefore, according to the ATO's position, the most important factor is the holistic consideration of the contract between the parties to determine whether, on balance, the worker is an employee or independent contractor. This requires an approach which involves standing back and viewing the contract from a distance such that an informed, considered, qualitative appreciation of the whole can be undertaken. In conjunction with the ruling, the ATO has also released a practical compliance guideline (PCG 2023/2 *Classifying workers as employees or independent contractors – ATO compliance approach*) which sets out its compliance approach for businesses that engage workers and classify them as employees or independent contractors.

Source: www.ato.gov.au/law/view/view.htm?docid=%22TXR%2FTR20234%2FNAT%2FATO%2F00001%22
www.ato.gov.au/law/view/view.htm?docid=%22COG%2FPCG20232%2FNAT%2FATO%2F00001%22
www.hcourt.gov.au/assets/publications/judgment-summaries/2022/hca-1-2022-02-09.pdf
www.hcourt.gov.au/assets/publications/judgment-summaries/2022/hca-2-2022-02-09.pdf

ATO's continued focus on illegal early release of super

In 2024, the ATO is continuing to target illegal early release of superannuation, which significantly impacts the retirement savings of Australians and can lead to an increased reliance on taxpayer-funded pensions in the future. In order to weed out illegal early release activities, the ATO has implemented various strategies and programs to gather intelligence for its risk detection models in order to initiate compliance action where appropriate. As in previous years, these strategies will be used in conjunction with guidance and education support for new trustees.

As a new calendar year commences, the ATO's priorities in the self managed super fund (SMSF) sector remain consistent. As in previous years, the greatest area of concern for the ATO continues to be taxpayers illegally accessing their super before meeting a condition of release. While it notes that the vast majority of SMSFs follow the rules, those that do not are having a significant impact on the system.

According to the ATO, early withdrawal of super seriously impacts a member's retirement savings, which can lead to an increased reliance on taxpayer-funded pensions (such as the Age Pension) in the future. This is in addition to significant financial and regulatory impacts for individuals, because illegally accessed benefits are assessable as income, and the ATO may apply and seek penalties, interest charges and disqualifications.

In order to weed out the few bad apples, the ATO implemented a program late in 2023 called "illegal early access estimate" which allows it to estimate the amount of retirement money leaving the system before it should. The information from the program informs the ATO of the size, scale and trajectory of the illegal early access risk and gathers intelligence to assist in addressing the issue.

This program will be used in conjunction with preventative approaches such as providing support and guidance products and education courses for new trustees. For example, the ATO continuously improves publications available on its website to support trustees in meeting their obligations at different stages of the SMSF lifecycle. It has also developed several online learning modules focused on the lifecycle of SMSFs, which will go live very soon.

Another preventative strategy employed by the ATO is an initial review of new registrants, which involves a risk assessment of all SMSF registrations to ensure trustees are entitled to set up a fund, and acts as a safeguard against identity fraud. The ATO estimates that in 2023 the initial review strategy protected against around $64 million of super savings leaving the system.

For new entrants into the SMSF system, the ATO has tailored the first-time non-lodgers program, which identifies and takes actions against funds that have received a rollover from a member but have not yet lodged their first annual return. In the first instance, a letter will be sent advising that if super has been illegally accessed, any amounts will need to be included in personal income tax returns. The ATO advises that taxpayers should respond immediately after the receipt of such a letter otherwise significant consequences may apply.

In situations where trustees fail to meet their lodgment obligations in relation to annual returns and other reporting requirements, the ATO will withhold the SMSF's complying fund status on SuperFund lookup as a first step to restrict the fund from receiving rollovers and employer contributions. For trustees and SMSFs that continue to evade their obligations, ATO compliance action will be initiated.

On the topic of compliance action, the ATO has warned that it uses increasingly sophisticated risk detection models which resulted in a significant number of sanctions being applied last year. In 2023, it disqualified 753 trustees – triple the number from 2022 – and raised around $29 million in additional tax, penalties and interest. The use of this detection model is set to continue in 2024.

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