Growth

Economy

Governing for Growth

Federal Budget 2017-18 Review

May 2017

“The budget contains some welcome measures to rebalance the economy and help small business. However, mid-sized companies deserve more support as they are Australia’s best shot at growing the economic pie.”

Greg Keith
Chief Executive Officer, Grant Thornton Australia

Foreword

The 2017–18 Budget represents the federal government's attempt to 'defrost' public hostility amid rising populist sentiment in the electorate. While committing to continued growth and a budget surplus by 2020–21, the government has acknowledged the nation's prosperity is not being evenly shared. This is an urgent challenge as Australia's economy confronts globalisation, technological change and the end of the mining boom.

The Budget targets Australia's big five banks, multinational tax avoiders, foreign workers and foreign resident investors, while making voter-friendly announcements relating to health, education (particularly schools funding), infrastructure spending and housing affordability.

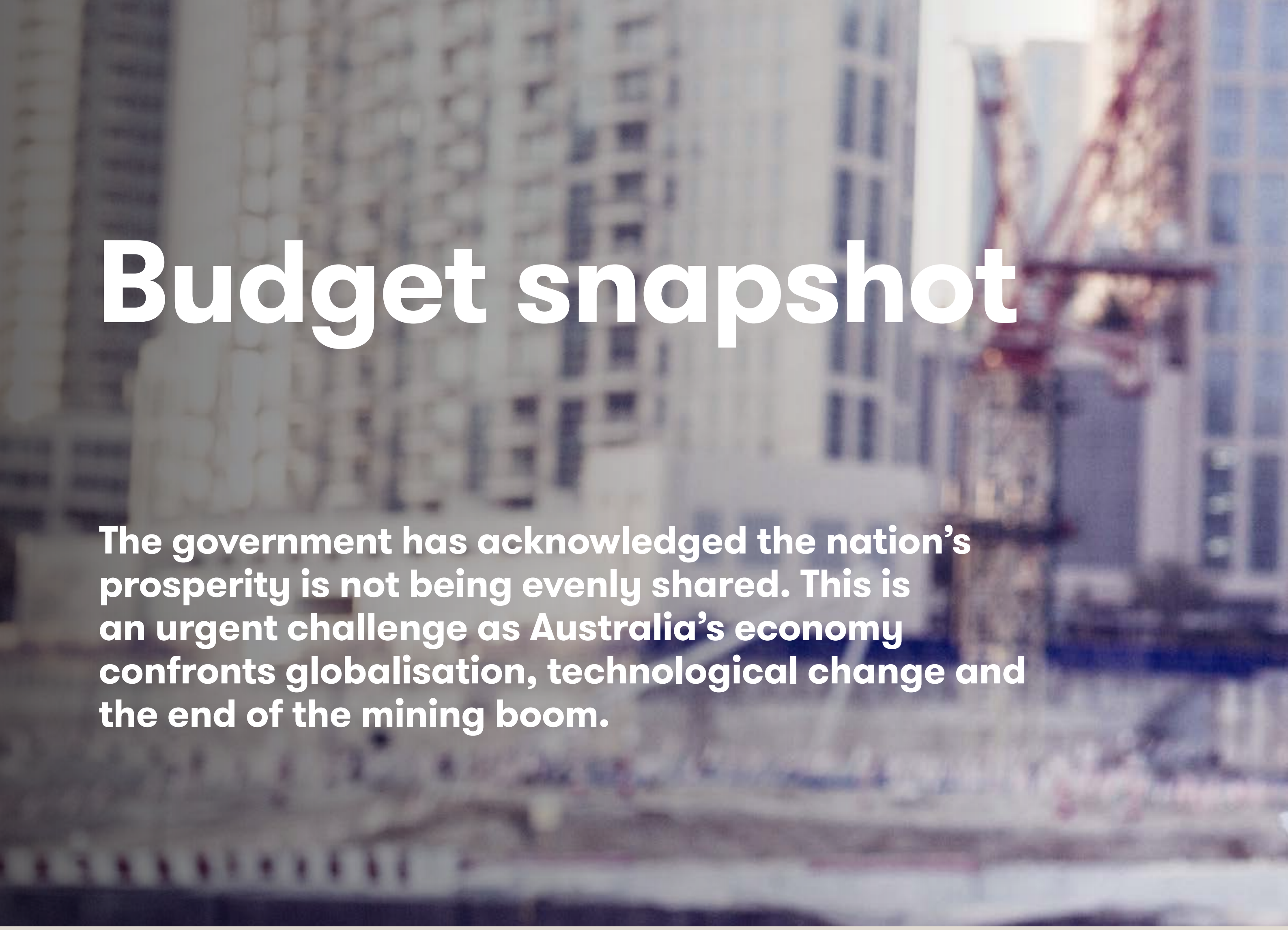
Support for companies is focused on small businesses. For example, last year's Budget measure allowing enterprises with an annual turnover of up to $10 million to immediately write off asset purchases of up to $20,000 has been extended for another year. This follows the government's achievement in getting $20 billion of its promised $50 billion in company tax cuts passed by parliament. Companies earning up to $50 million will have their tax rate reduced from 30 per cent to 25 per cent over 10 years.

While these represent welcome measures to help small businesses navigate the global economy, it is important that the same logic be applied to all companies. Mid-size businesses (MSBs) – defined as having an annual turnover of between $10 million and $500 million – play a central role in driving innovation and growth. Reversing a decade of deficits will require MSBs to perform their share of heavy lifting, and every effort should be made to give them a spur.

Unfortunately, the Budget has again excluded MSBs from the government's asset write-off initiative. MSBs may face a tighter lending environment due to the new levy on banks. They will also incur significant new financial penalties for hiring foreign workers – potentially hurting their ability to source vital overseas talent. On the positive side, while cutting funding to universities, the government has kept research and development incentives intact.

Australia's company tax rate is not particularly competitive when measured against its major trading partners. This situation will only worsen if the Trump administration succeeds in reducing the rate in the United States to 15 per cent. Despite being stymied by the Senate, we believe the government's original company tax cut plan is worth supporting in full. This should form part of a comprehensive suite of measures, including more cuts to red tape and shifting reliance from income tax to the GST.

Australia deserves a simpler, more modern tax system that drives long-term growth for all businesses.



Budget snapshot

The government has acknowledged the nation's prosperity is not being evenly shared. This is an urgent challenge as Australia's economy confronts globalisation, technological change and the end of the mining boom.

Budget deficit

$35b	FY16 forecast
$39.6b	FY16 actual
$37b	FY17 forecast
$36.5b	FY17 projected
$29.4b	FY18 forecast
$7.4b	FY21 projected return to surplus

The winners

1. Small businesses
2. Beneficiaries of the housing affordability package
3. Suppliers to infrastructure projects

Investments

↑ $18.6b
over next 10 years
Education

$1.5b
to be raised in 4 years
Bank levy

$1b
Medicare defrost

↑ $75b
over next 10 years
Infrastructure

$6b
Fully funding
National Disability
Insurance Scheme

$472m
Regional fund

Tax measures

Company tax rates

The government has confirmed its intention to reintroduce its full plan to eventually reduce the company tax rate to 25 per cent for all companies. This is a step in the right direction in keeping Australia competitive with our international trading partners. However, the key question is whether the current government will be able to pass these proposed laws through parliament, having already encountered significant opposition. Nevertheless, we urge the government to introduce these changes as soon as possible as discrepancies between Australia's corporate tax rate and those of our OECD trading partners continues to grow.

Company tax rate changes – which the Senate has already restricted to only apply to smaller businesses – are summarised in the following table. Note that these changes are yet to be approved by the House of Representatives.

Financial year	Aggregated turnover less than	Company tax rate
2016–17	$10m	27.5%
2017–18	$25m	27.5%
2018–19	$50m	27.5%
2019–20 to 2023–24	$50m	27.5%
2024–25	$50m	27%
2025–26	$50m	26%
2026–27+	$50m	25%

Tax integrity measures

The government moves to close loopholes being exploited by multinationals and banks

The government has acted quickly to close down structures such as partnerships and trusts, which are being used to negate recently enacted measures to combat multinational tax-avoidance. The anti-avoidance measures will only apply to groups with a global turnover of $1 billion or more. While the attempt to ensure a level playing field is welcome, more detail is needed to ensure that this is not an attack on legitimate commercial structures.

Continuing the theme of taxing the big banks, the government has also announced measures targeting banks and other financial institutions that implement 'hybrid mismatch' arrangements.

The government will continue to target the black economy

As part of the government's continued focus on the black economy, it will provide $32 million to extend the funding of audit and compliance programs by the Australian Taxation Office (ATO) for another year. These programs are designed to counter behaviours related to the black economy, such as non lodgement of tax returns, omission of income on returns and non payment of employer obligations.

A further focus of the government is to prohibit the manufacture, distribution, possession, use or sale of electronic point-of-sale suppression technology and software, which can be used to delete selected transactions from electronic records.

The ATO will continue its compliance work against serious and organised crime

The government will provide $28.2 million to the ATO to target serious and organised crime in the tax system. This extends an existing measure by a further four years, to 30 June 2021.

The government recommits to reduce the company tax rate for all companies

Employment taxes and skills shortages

Visa levy on foreign workers

On the back of the recent move to replace the popular 457 visa, from March 2018, businesses that employ foreign workers on certain skilled visas will be required to pay an additional levy. The levy will be payable up front and then on an annual basis for the new Temporary Skill Shortage visa.

Business turnover	Levy – Temporary Skill Shortage visa	Levy – permanent visa pathway (subclasses 186 and 187)
Below $10 million	$1,200 per year	$3,000 one-off payment
$10 million or more	$1,800 per year	$5,000 one-off payment

It is disappointing that the additional levy and significant associated increases in visa application charges will add further costs to businesses that rely on skilled overseas workers to develop and grow. On the positive side, the measures are estimated to generate additional revenue of $1.2 billion for the training and development of Australian workers who can fill skill shortages in the medium to long term.

Higher education reform

The government has unveiled extensive changes to the fee structure of Higher Education Loan Program (HELP) schemes. These changes include a decrease in the minimum repayment threshold, as well as significant amendments to repayment rates.

The government also announced an annual increase in student contributions of 1.82 per cent, totalling approximately 7.5 per cent over a period of four years. The increase will come into effect from 1 July 2018. A restriction on subsidies will limit government assistance to Australian citizens and Special Category visa permanent residents, with assistance to be withdrawn from many Commonwealth supported places.

These changes will be viewed as part of the government's broader initiatives to promote and strengthen the Australian skilled workforce. They also complement the recent introduction of the Temporary Skill Shortage visa regime. However, increasing the cost of access to education could further exacerbate skills shortages in the long term.

Personal tax

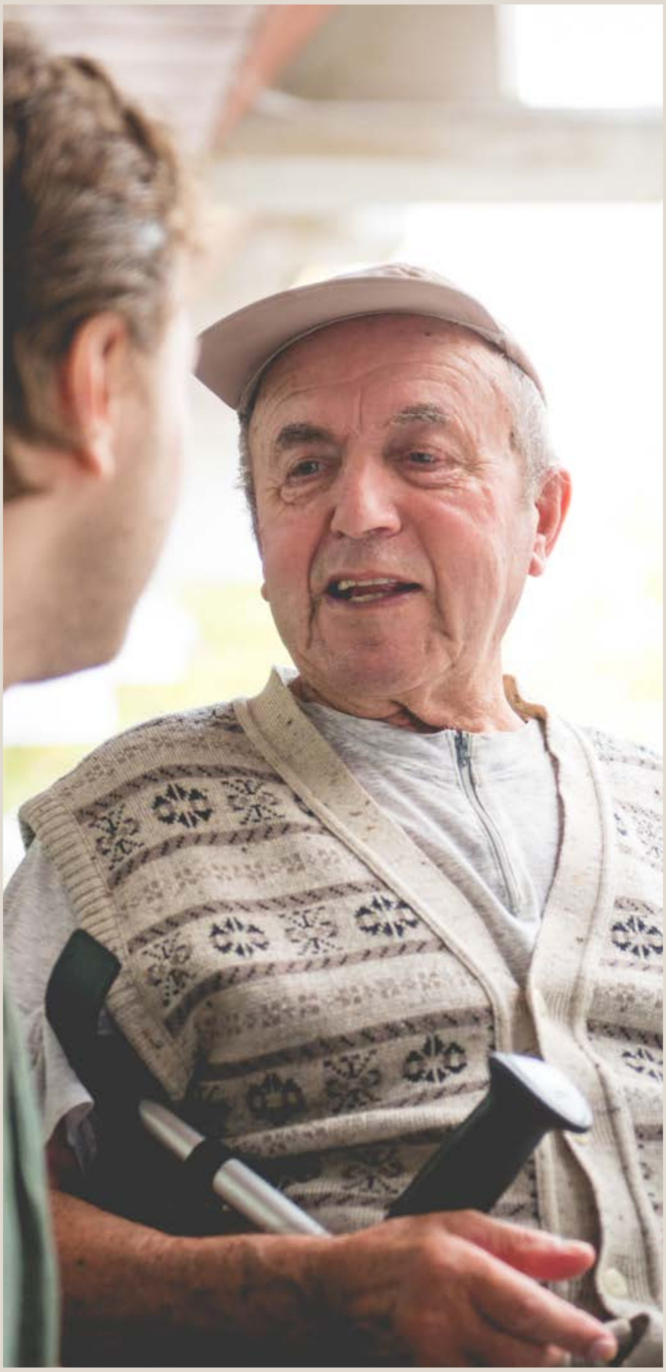
Changes to the Medicare levy

The 2017–18 Budget did not introduce any changes to individual income tax rates. As a result, the most significant income tax change impacting individual taxpayers is the increase in the Medicare levy from 2 per cent to 2.5 per cent from 1 July 2019. The government has made clear its intention to apply the resulting $8.2 billion in additional revenue toward funding the National Disability Insurance Scheme.

The generic increase in the Medicare levy will likely be viewed by business as a way for the government to compensate for the loss of revenue from the Temporary Budget Repair levy, which will cease to apply from 30 June 2017. However, unlike the budget repair levy (affecting only those who earn more than $180,000), the Medicare levy is not means tested, except against low-income thresholds. Minor increases in the low-income thresholds, to $36,541 for families and $21,655 for individuals, are unlikely to mitigate the impact of the Medicare levy increase on low-income households.

This change is further expected to affect medium-sized businesses as employees seek to offset the increase in Medicare levy by negotiating improved remuneration packages.

Health & aged care



Health

Key points:

- Allocation of $1 billion to lift the Medicare rebate freeze, providing greater funding certainty to GPs
- Indexation of bulk billing incentives for children aged under 16 and concession cardholders
- Reversal of the removal of the bulk billing incentive for diagnostic imaging, including mammography, fluoroscopy and interventional radiology
- Legislation to guarantee the future of Medicare and the Pharmaceutical Benefits Scheme
- An increase in hospital funding of $2.8 billion over four years, with additional support for veterans' health, mental health and rural telehealth psychological services.

Commentary:

The government is looking to cauterise its vulnerabilities on health that began with the 2014–15 Budget. 'Defrosting' the Medicare freeze could terminate a debilitating political dispute with the nation's GPs. It will also encourage greater bulk billing for Australians visiting a doctor, helping them to keep out-of-pocket costs in check. There is also the potential for greater health industry consolidation as the increased profitability of service providers drives mergers and acquisitions and initial public offerings.

Aged Care

Key points:

The introduction of new financial incentives to support retirees downsizing their homes

Increased funding for home-based palliative care

Reforms to aged care financing, including limits on the indexation of complex care and stricter targeting of viability supplements.

Commentary:
The Budget encourages older Australians to downsize into homes that better suit their needs by allowing them to place up to $300,000 in sale proceeds into superannuation. This will give retirees access to more funds for their care in later life. The changes to palliative care will provide opportunities for home care providers to increase services. Conversely, changes to the Aged Care Funding Instrument will impact the profitability of aged care service providers at a time when cost pressures are increasing due to mandatory staffing ratios. Deterring investment in the sector is especially problematic at a time when demand is significantly increasing.

NDIS

Key points:

A full funding guarantee of the National Disability Insurance Scheme (NDIS) beyond 2019, at a cost of about $6 billion

Greater flexibility for Australian Disability Enterprises, as the government transitions to new wage arrangements for supported employees

A new NDIS Savings Fund Special Account to help meet the future costs of the NDIS

Substantial efficiencies to be gained:

- $1.4 billion over five years by closing relevant unnecessary carbon tax compensation to new recipients of government welfare benefits
- $108.6 million over four years by aligning the backdating provisions for new Carer Allowance claims with other social security payments. From 1 January 2017, the Carer Allowance will be payable to eligible applicants from the date of the claim, or the date they first contact the Department of Human Services. The government has already factored in savings from this component
- $62.1 million over five years by reviewing 30,000 Disability Support Pension recipients every year for three years. The review process will assess recipients' capacity to work
- $66.7 million by identifying funds not spent in 2015–16, and by not proceeding with the NDIS advertising campaign.

Commentary:
By promising that the scheme will be funded, the budget provides far greater certainty to NDIS providers and consumers, and helps mental health providers overcome some uncertainty over NDIS funding. Questions remain as to whether funding cover is based on initial forecasts or amended forecasts arising from experiences at trial sites.

Housing affordability

The government has delivered on its commitment to tackle housing affordability, despite acknowledging that there are no silver bullets. The budget contains measures that address factors on the supply and demand sides, although notably, the government has kept its promise to leave negative gearing alone.

Demand-side measures

In this budget, the heavy lifting around housing affordability has fallen on those who lack an electoral voice. A raft of capital gains tax (CGT) and other measures aim to maximise revenue collection from foreign residents (and temporary tax residents). This will likely suppress investor confidence and demand for Australian residential property.

Measures specific to foreign investors include:

- removing the main residence exemption – effective immediately – for non-residents and temporary residents, but with a two year stay of execution for existing holdings until 30 June 2019. This could be bad luck for New Zealand residents who have permanently relocated to Australia but never applied for a permanent resident status (or married an Australian)

- extending the scope of the comparatively new CGT withholding regime, by slashing the threshold from $2 million to $750,000. Given the average dwelling price across Australia's five capital cities of just over $825,000, the regime will now cover significantly more transactions. Coupled with an increase in the withholding rate of 2.5 per cent to 12.5 per cent, this should significantly reduce the risk of foreign investors failing to pay tax on property transactions

- making foreign investors who apply to acquire residential property in Australia subject to a 'ghost tax' if they leave their property unoccupied or unavailable for rent for six months or more each year. The annual levy will be equal to the foreign investment application fee, and will be policed by the Australian Taxation Office (ATO) along with its other Foreign Investment Review Board (FIRB) responsibilities

- introducing a 50 per cent cap on foreign ownership in new developments, achieved by imposing additional conditions on New Dwelling Exemption Certificates.

While there was plenty in the budget for property developers and investors to digest, the real work will be for those whose roles involve educating potential foreign investors on the additional costs of investing in Australian property.

Unlocking supply

The government has sought to ensure the supply of housing keeps pace with population growth – and to encourage a more responsive housing market – through several measures. They include:

- encouraging first home buyers by allowing them to withdraw future voluntary super contributions of up to $30,000 for a first home deposit from 1 July 2017, along with associated deemed earning

- extending the CGT general discount from 50 per cent to 60 per cent in the circumstance of investments in eligible affordable housing only

- providing community housing groups with access to long-term, low-rate loans, so that more low-cost rentals and affordable housing options can hit the market

- working with state and territory governments to set housing supply targets and facilitate planning and zoning reform, under a new National Housing and Homelessness Agreement

- establishing a $1 billion National Housing Infrastructure Facility to address infrastructure limitations – such as transport links, power and water infrastructure, and site remediation works – that currently impede housing development in critical areas of undersupply

- establishing an online Commonwealth land registry, allowing and encouraging private sector proposals for higher-value land use (including housing development). An early example is the release of substantial Defence land in Maribyrnong, Victoria, which is within 10 kilometres of the CBD and could support up to 6,000 new homes

- exempting retiree downsizers from various superannuation caps if they deposit proceeds from the sale of the family home into their super funds

- changing the Managed Investment Trust (MIT) regime to offer additional concessions for investment in affordable housing.

Given that many of the levers for improving housing affordability fall under the control of states and territories, the government will be expecting their support in executing this strategy. Hopefully this means discussions about wholesale tax reform – especially addressing inefficient taxes such as stamp duty – will rise to the surface very soon.

Bailing up the big banks

Key points:

A levy for big banks – including ANZ, Commonwealth Bank, Macquarie, National Australia Bank and Westpac – that have liabilities of at least $100 billion, a threshold that will be indexed to grow in line with nominal gross domestic product (GDP)

Levy to be calculated quarterly as 0.015 per cent of an authorised deposit-taking institution's (ADI's) licensed entity liabilities

Will be imposed on various types of borrowing banks use to fund their lending, including corporate bonds, commercial paper, Tier 2 capital instruments and large deposits, but will not be imposed on shareholder capital and smaller deposits (under $250,000) protected by the Financial Claims Scheme

Intended introduced on 1 July 2017, forecast to raise $1.5 billion over the next four years

Australian Competition and Consumer Commission (ACCC) to conduct an inquiry into residential mortgage pricing until 30 June 2018.

Commentary:

The government's imposition of a banking levy is a surprise move designed to reinforce its populist credentials. It also takes political ammunition away from the opposition, which has struck a chord with its call for a Royal Commission into the banking industry. The levy is designed to complement the government's prudential reforms, which the Australian Prudential Regulation Authority (APRA) is currently implementing, and will provide a more level playing field for smaller banks and non-bank competitors.

Presumably, boosting the ACCC's review powers is an attempt to dissuade banks from passing on the costs of the levy directly to customers – for example, in the form of increased lending rates or lower deposit rates. The budget papers state that "As part of this inquiry, the ACCC will be able to require relevant ADIs to explain changes or proposed changes to residential mortgage pricing, including changes to fees, charges, or interest rates by those ADIs". The overall effect remains to be seen.

"A number of positive announcements were made that hold the promise of stimulating growth within the family business sector. With family businesses accounting for approximately 70% of all Australian businesses, this will help drive broader economic growth into the future."

Kirsten Taylor-Martin
Partner, Private Advisory

Stimulating growth for Family Businesses

Key points:

Small Business Tax Concessions: the Government continued their push for a decrease in the business company tax rate and an increase in the turnover threshold for small business. It is important to note that if you operate a business in a family trust and distribute profits to a company, the company is not classified as a business and therefore the tax rate will remain at 30%.

$20k Small business immediate deduction: This immediate write off on depreciable items continues to 30 June 2018, with the turnover threshold increasing from $2m to $10m turnover.

Small Business Capital Gains Tax Concessions: CGT Small Business Concessions to only apply to business assets.

Cash economy crackdown: The Government has announced they will be focussing on the cash economy. This is great news for family businesses as it ensures fairness across the economy.

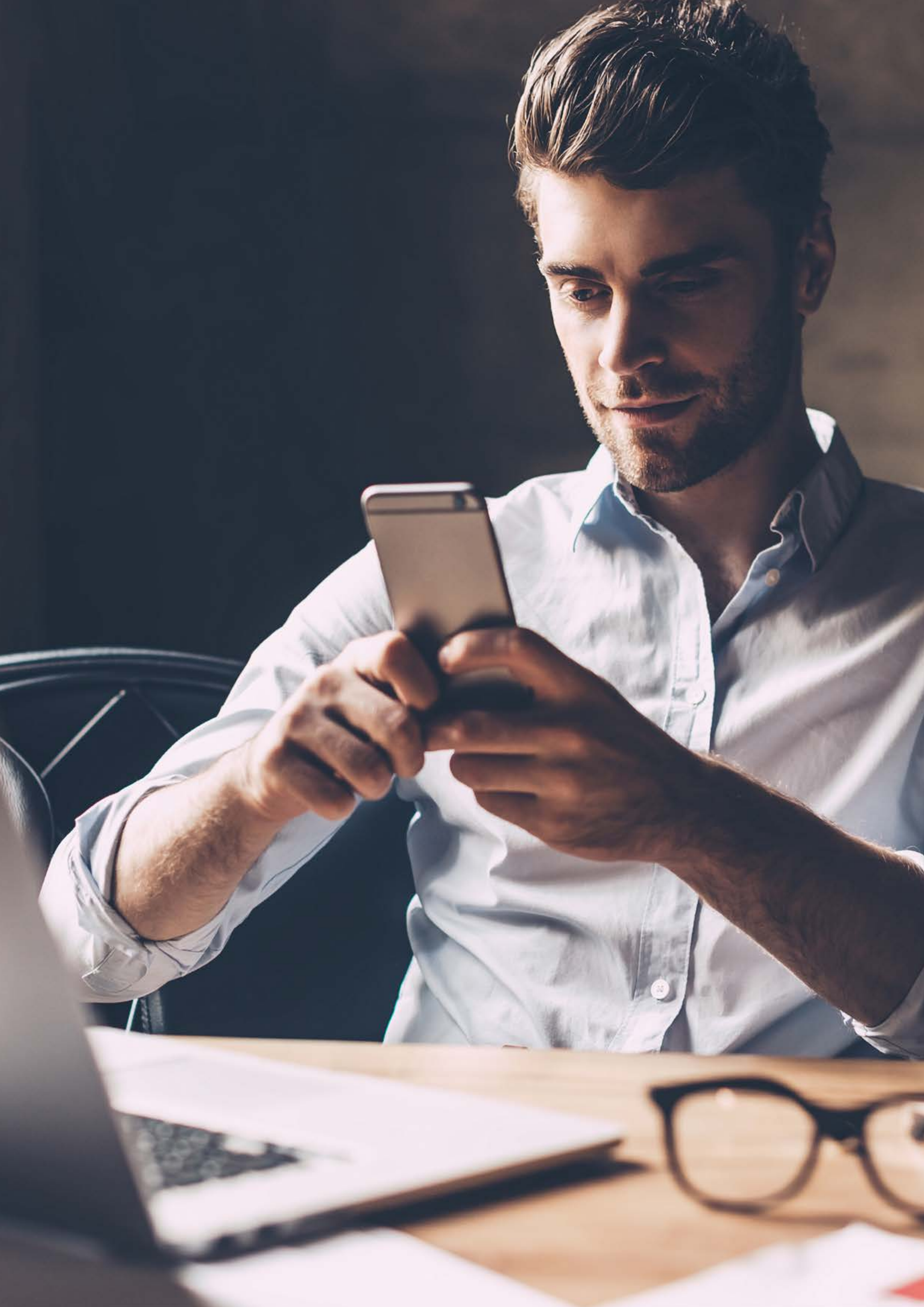
Commentary:

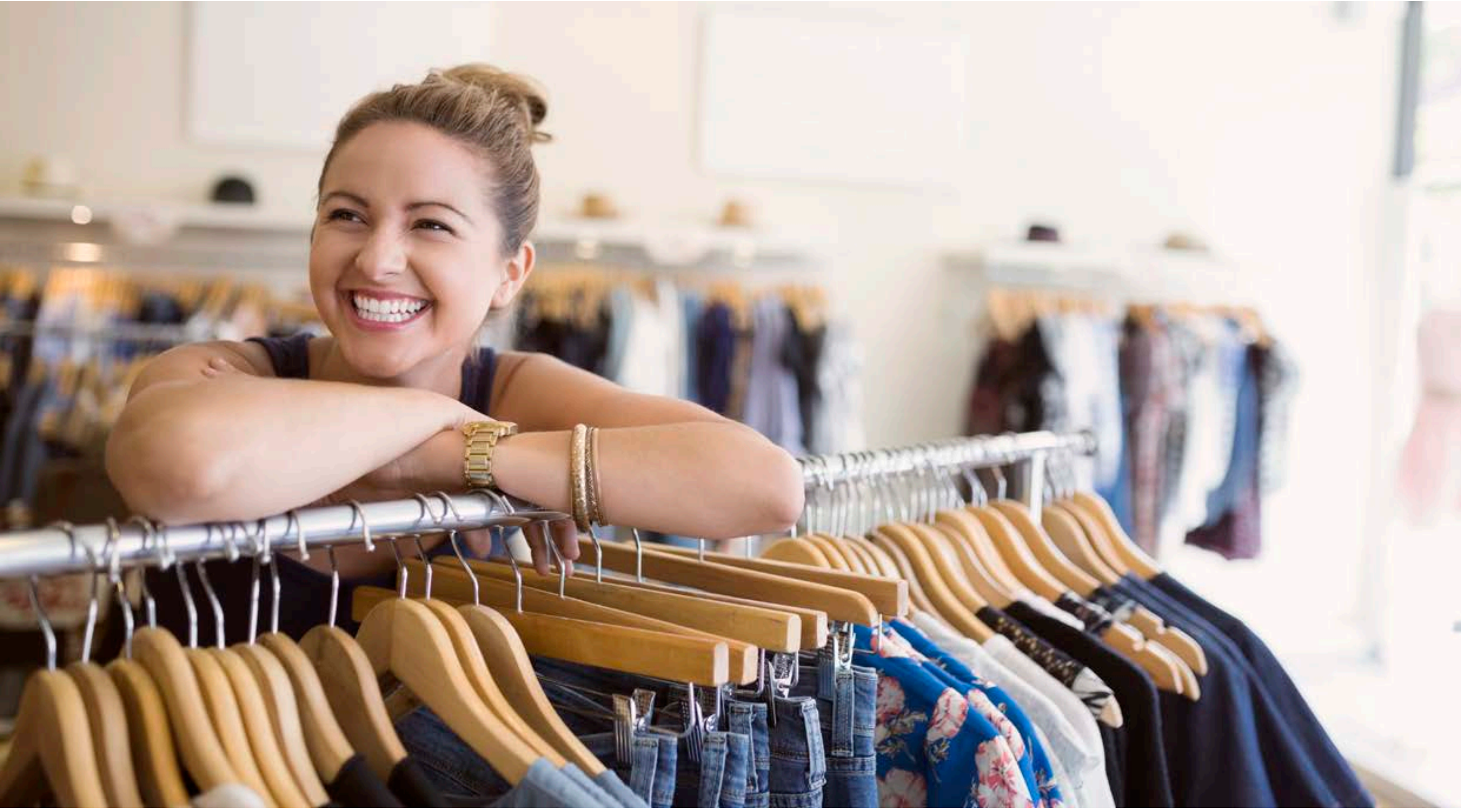
The budget takes small steps in the right direction and will particularly assist family businesses with a turnover of <$10m. The write-off on depreciable items presents a great incentive for small business to invest in capital, and the decreasing tax burden will also free up funding for investment into jobs and innovation.

Importantly, while the budget caters to the growth settings for smaller business, we note there is nothing specifically aimed at enabling growth for mid-sized family-owned businesses.

70%

of Australian companies are family business





Consumer products & retail

Key points:

- Specialised retailers to be hit hard by the new levy on employing foreign workers
- GST deferred on low-value imports for another 12 months
- Lower company tax rate will help retailers

Commentary:

Australia's retail and consumer goods sector is under serious pressure. The budget measures to improve housing affordability and banking competitiveness have the potential to improve consumer confidence and, accordingly, growth and sustainability for retailers. Conversely, penalising businesses for hiring foreign workers could discourage the employment of specialised, tech-savvy talent and affect the sector's ability to innovate. This is particularly the case in e-commerce, an area in its infancy in Australia.

The Budget reinforced the government's commitment to reduce the company tax rate. This guarantees that many Australian retailers will have an effective tax rate of 25 per cent by 2027. However, Australian retailers remain disadvantaged considering the lower tax rate paid by many of their global competitors. Retailers will also be disappointed to discover that plans to impose the GST on low-value imports have been deferred for another 12 months. This will disadvantage them in comparison with international retailers, particularly those that dominate the online sector.

Goods and Services Tax

Purchasers to pay goods and services tax on new residential premises

Until now, residential property developers have been responsible for remitting goods and services tax (GST) on sales of new premises to the ATO. This is because the GST is included in the purchase price. In an interesting budgetary move, the government will now require purchasers of new residential premises to remit the GST on their purchase directly to the ATO, effective from 1 July 2018. This will remove the developer from the equation. The reason for this measure is that some developers are failing to remit the GST to the ATO despite having claimed GST credits on their construction costs.

However, the practicalities of implementation are not clear. One outstanding question involves the role of conveyancers. A potential solution could be to apply the current stamp duty collection model, where conveyancers or lawyers collect the stamp duty on behalf of the purchaser and remit this directly to the State Revenue Office.

In instances where the developer and purchaser agree to use the margin scheme, the developer will now have to, in effect, disclose his or her margin when supplying GST information to the purchaser at settlement. This is unexpected and unprecedented in terms of commercial sensitivity for property developers. We look forward to reviewing the proposed legislation showing how this change is to be enacted.

Digital currency and GST

From 1 July 2017, digital currency (for example, bitcoin) will be treated the same as money for GST purposes. Previously, the GST applied to supplies of digital currency made within Australia by registered entities. However, this has led to a form of double taxation in which GST is applied on the purchase of the digital currency and again when the currency is used in exchange for other goods and services subject to GST.

The proposed change will remove this double taxation, and digital currencies will no longer be subject to GST. This will have a positive impact on the fintech sector.

Low-value imports

The issue of whether GST should apply to low-value imported goods has been the subject of many reviews and extensive research.

On 23 March 2017, the government's bill to extend GST to low-value goods imported by consumers was referred to the Senate Economics Legislation Committee. The committee published its final report on 9 May 2017. It noted concerns about the proposed implementation date due to the complexities of the proposed collection mechanism and the policing of non-compliance. It recommended that the bill pass but that the introduction of the new tax be delayed to 1 July 2018.

We expect that various collection models will be debated and that a sensible approach will be taken from a compliance perspective.

Infrastructure

The budget allocates more than $70 billion for new infrastructure projects, but none of the large infrastructure commitments are included in the allocated operating or capital expenditures. Instead, the government has deliberately applied a broad-brush approach to classifying debt as either 'good' or 'bad'. This appears to be a clever strategy for moving non-recurrent expenditure off the government's balance sheet and getting the budget into surplus sooner.

As was announced prior to the budget, the Treasury's consultation period in relation to the use of stapled structures has been extended until the end of July 2017, to allow for more time for industry consideration. It is broadly expected that the Treasury will narrow the infrastructure industry's ability to use stapled structures.

Key infrastructure announcements

$10b

National Rail Program – to better connect cities, reduce congestion and revitalise regional Australia

$5.3b

Western Sydney Airport Corporation

$8.4b

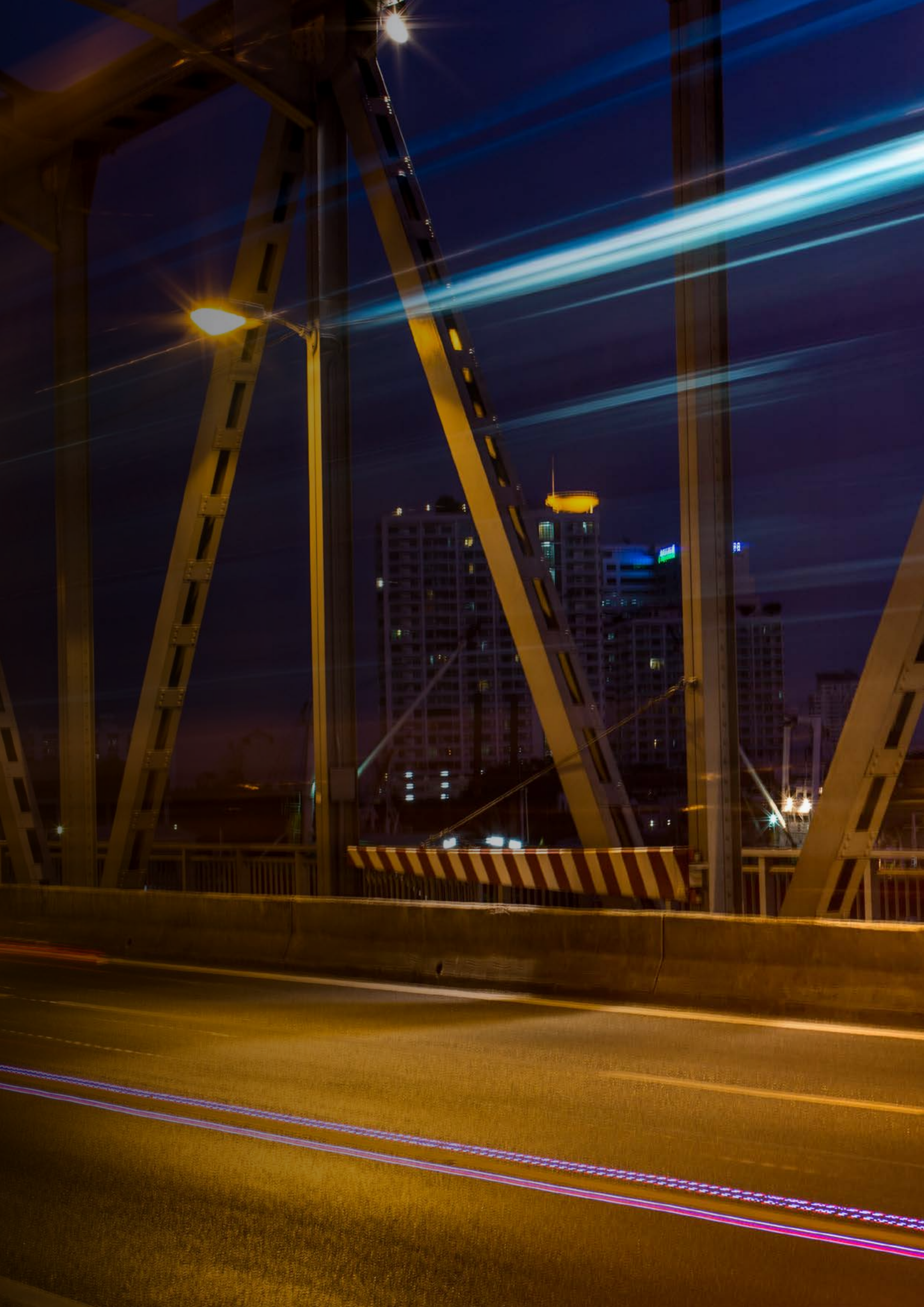
Australian Rail Track Corporation – for development of the Inland Rail project from Brisbane to Melbourne (part of the National Rail Program)

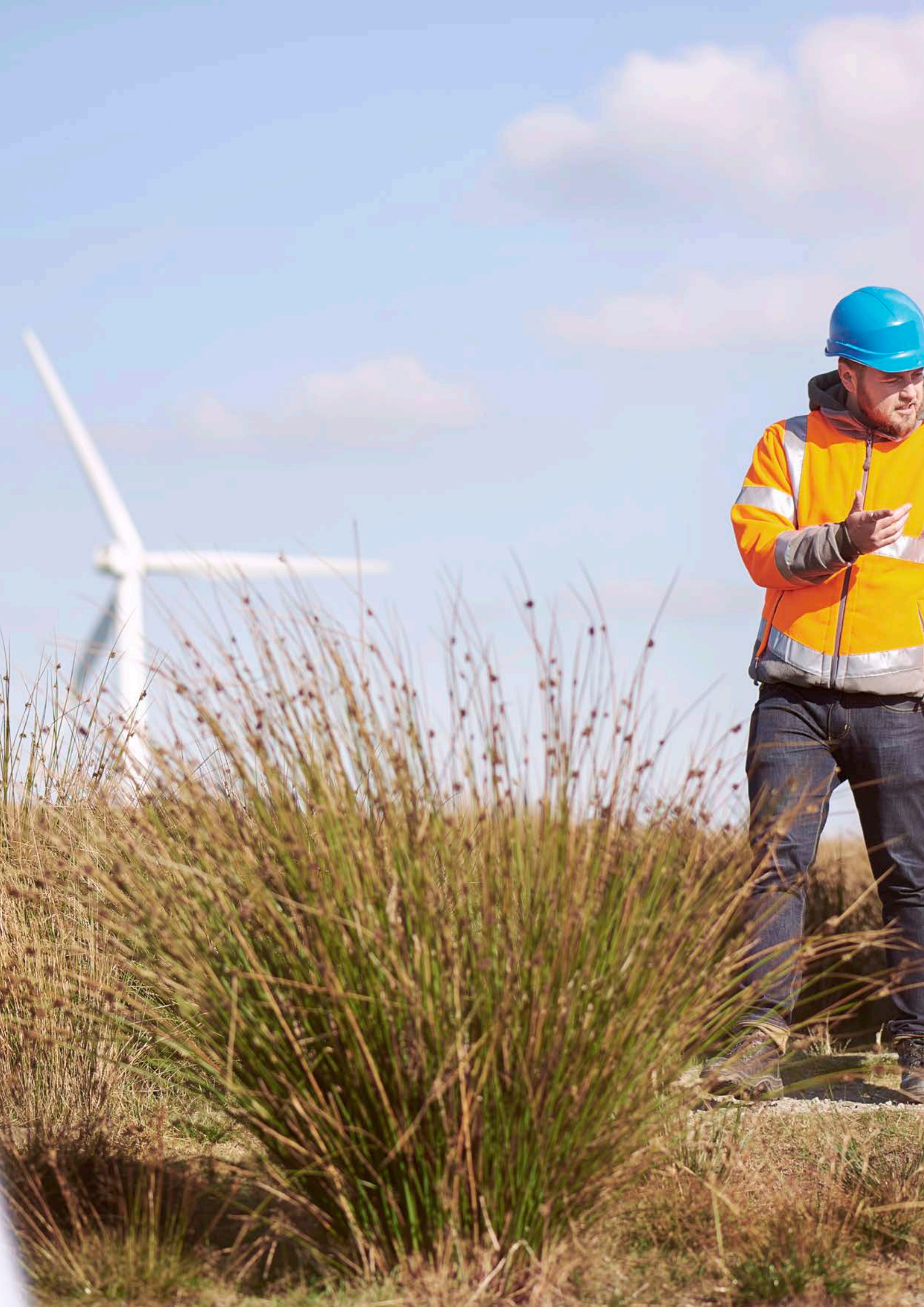
$908m

Infrastructure Investment Program – upgrades to major regional roads

$472m

Regional Growth Fund – grants for major transformation projects





Energy & resources

Key points:

Additional funding for Australian Competition and Consumer Commission (ACCC) gas market monitoring and pricing review

$68 million towards development of onshore unconventional gas infrastructure, including research into west-to-east and north-to-south national connectivity

Funding for the Commonwealth Scientific and Industrial Research Organisation (CSIRO) to complete and distribute energy use modelling

Special funding for South Australia to support investment in energy infrastructure and prevent grid issues.

Commentary:

The recent faltering of Australia's electricity and gas energy markets has made the sector a focus of national attention. This budget provides additional funding for the ACCC to establish a monitoring regime for the gas market. It also sets aside $86 million in funding for onshore unconventional gas development aimed at improving the efficiency of the domestic market. This includes funding for studies into potential links between the Western Australia and East Coast gas markets via South Australia, and similarly between the Northern Territory and South Australia. In our view, a fully connected gas market should help improve supply to the key industrial areas of NSW and Victoria.

There is also funding for the ACCC to review retail electricity prices, and additional funding for the Australian Energy Regulator to ensure appropriate competition in wholesale energy markets. Government funding will allow the CSIRO to complete its Energy Use Data Model and release this information to regulators and the industry.

Following the 2016 blackouts in South Australia, the state will receive specific funding as part of an asset recycling fund for investment in energy infrastructure. This funding, which aims to alleviate ongoing grid issues, includes the possibility of investing up to $110 million in a solar thermal project at Port Augusta.

Offices

Adelaide
Grant Thornton House
Level 3, 170 Frome Street
Adelaide SA 5000
T +61 8 8372 6666
E info.sa@au.gt.com

Brisbane
Level 18, 145 Ann Street
Brisbane QLD 4000
T +61 7 3222 0200
E info.qld@au.gt.com

Cairns
Cairns Corporate Tower
Level 13, 15 Lake Street
Cairns QLD 4870
T +61 7 4046 8888
E info.cairns@au.gt.com

Melbourne
Level 30, The Rialto
525 Collins Street
Melbourne VIC 3000
T +61 3 8320 2222
E info.vic@au.gt.com

Perth
Level 1, 10 Kings Park Road
West Perth WA 6005
T +61 8 9480 2000
E info.wa@au.gt.com

Sydney
Level 17, 383 Kent Street
Sydney NSW 2000
T +61 2 8297 2400
E info.nsw@au.gt.com

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