Grant Thornton
An instinct for growth™

Federal Budget 2015-16

Friend or foe to mid-size businesses?

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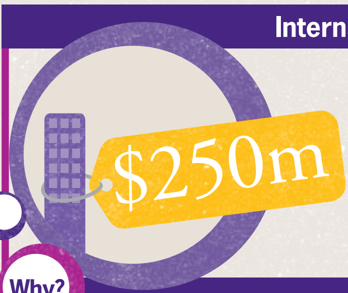
Mid-size businesses in Australia do much of the heavy lifting when it comes to creating employment opportunities and national prosperity. Yet they are often inconspicuous and under-supported by government. Many are questioning whether this year's budget will be friend or foe to mid-sized businesses.

International expansion



The cap on Austrade Export Market Development Grants should be increased to include businesses with turnover of up to $250m.

Why?

Australia's two-way trade in goods and services in 2013–14 totalled A$669 billion and mid-size businesses (MSBs) contribute substantially to this figure. Yet Export Market Development Grants focus on the small end of town, supporting firms with $50 million turnover or less. MSBs need support to trigger much of their international expansionary activity.

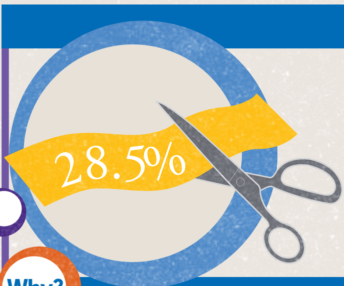
Managing talent to support growth

Faster and more efficient processing of business subclass 457 visa applications (reducing the process from months to weeks by selectively increased resourcing).

Why?

6.6% fewer subclass primary visas were granted in 2014-15 than 2013-14 due to cumbersome visa processing requirements. This is negatively impacting mid-sized business' ability to access the skilled talent from around the globe they need to deliver their business strategies and achieve their growth ambitions.

Tax relief

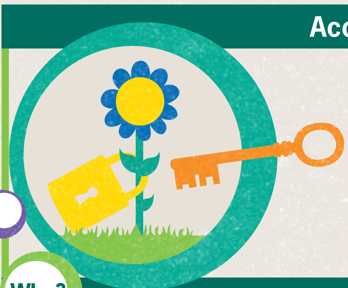


Reduce company tax to 28.5% to include mid-size businesses.

Why?

Australia's current 30% company tax rate perpetuates the competitive disadvantage faced by mid-sized businesses. The government has flagged a 1.5% reduction in the company tax rate for small businesses from 1 July, reducing the rate to 28.5%. Mid-sized business, which employs more people and are geared for growth, must be included in the rate relief.

Access to finance



Greater access to non-traditional financing options.

Why?

Most mid-size businesses (MSBs) are reliant on bank loans to fund their investment and growth. Yet they are often misunderstood by lenders, with the common perception being that MSBs present higher risk and more volatile cash flows. This lack of understanding has led to higher fixed costs - regulation and taxation - accessing capital.

Foreword

Mid-size businesses have a turnover between $5 million and $250 million annually, or between 50 and 499 employees.

Mid-size businesses (MSBs) in Australia make an outsize contribution to the Australian economy. With combined annual turnover in excess of $1.1 trillion, the MSB sector injects an estimated $241 billion into the economy annually in wages and salaries. Yet despite their economic heft, they're curiously invisible to government and generally under-supported. While small businesses are rewarded in this budget, many are questioning whether it is friend or foe to the MSB.

In New South Wales alone, MSBs generate around four million jobs. But they're the quiet achievers of the economy, obscured as they tend to be, between the populous small business sector and the heft of the large corporates, with their ability to generate and influence media attention and policy.

There were four measures that this budget could have delivered to support MSBs growth:

- Lifted the cap on export market development grants to $250 million to support international expansion.
- Delivered better departmental resourcing for faster and more efficient processing of business visas to allow MSBs to manage talent for growth.
- Reduced the company tax rate for MSBs because the middle market currently carries a disproportionate share of the tax burden
- Supported more flexible financing options from non-traditional sources

Whilst the Government has not delivered these specific measures, the changes build the foundation for moving towards greater support for MSBs - the engine room of the Australia economy. There are a number of measures that demonstrate the laying of the foundation.

Supporting exports and international expansion through Free Trade Agreements between Australia and China, Japan, Korea and, in the future, India, as well as the $5 billion of infrastructure investments in northern Australia will be welcome news for the mid-market, who are primed for export.

The Budget provides targeted spending on new jobs initiatives aimed at employers and young and old job seekers alike to encourage greater participation in the workforce. MSBs managing their talent pool will no doubt draw on these incentives as they look to grow.

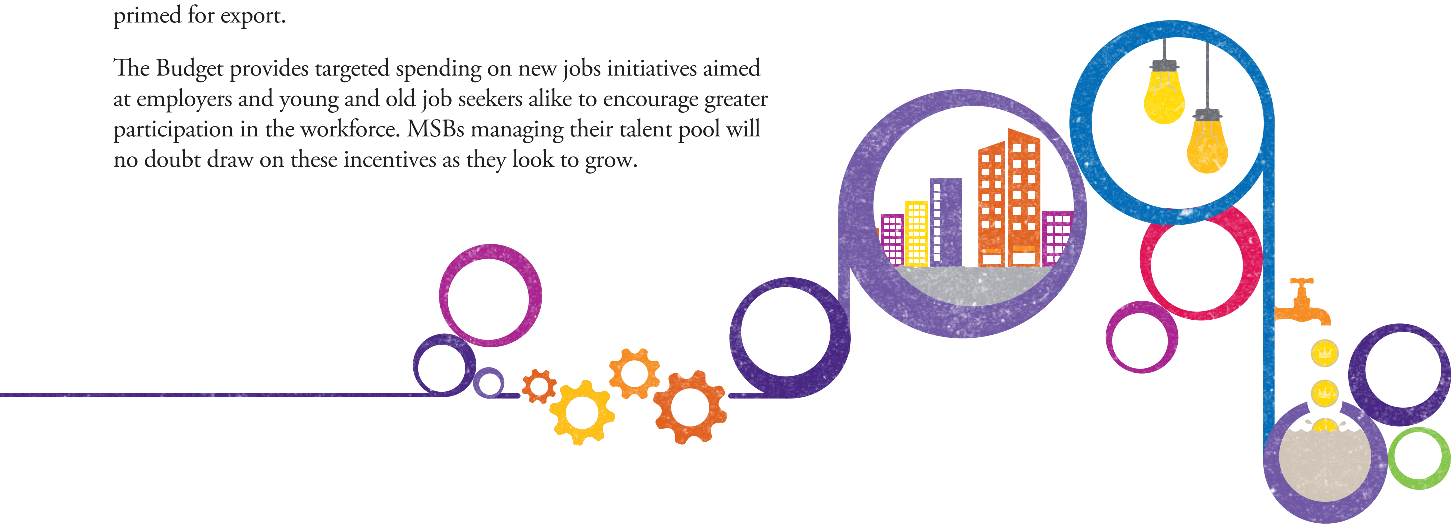
While support for small businesses (with turnover of less than $2 million), including reducing the company tax rate to 28.5% and access to immediate asset write offs for new investments up to $20,000 in value will no doubt be welcome for some, this relief should be extended more broadly across the economy to create a level playing field in Australia and internationally.

Encouraging crowd funding to help start-ups and small businesses is certainly a welcome measure, and we encourage the Government to expand this thinking to include other adjustments to policy and regulatory settings to create an environment for more non-traditional funding for Australian businesses. Superannuation and pension funds providing capital to MSBs as well as peer-to-peer lending could create a much more competitive funding landscape for the mid-market.

In listening to our MSB clients Government needs to put in place policy settings to boost investment, confidence and jobs and restore trust in the political process.

This Budget is a budget that both sides of Parliament should be able to arrive at a comprise that allows for the implementation of a majority of measures in part or full and will deliver the much needed political and economic certainty that MSBs are seeking from Federal Government.

Overall, we give the 2015/16 Federal Budget a 3/5 in its support of Australia's quiet chorus, MSB.



International expansion

Export market development grants (EMDGs) currently focus on the smaller players, supporting companies with $50 million in turnover or less.

Australia's two-way trade in goods and services in 2013–14 totalled A$669 billion and mid-size businesses contribute substantially to this figure. Yet EMDGs focus on the small end of town, supporting firms with $50 million in turnover or less. Additionally, the number of times grants can be sought is capped, regardless of whether business ownership has changed hands and the new owners have the drive and ambition to take the business into different markets.

Australia's free trade agreements (with Japan, Korea and China) are welcome initiatives for business. However, a lack of ongoing support for businesses and how they can best exploit the opportunities available, combined with the agreements' renowned complexity (often requiring specialist tax analysis) hampers much potential commercial activity.

Organisations of scale, such as MSBs, need support to trigger their expansionary activity. While we well know the resourcefulness and tenacity of these businesses, Grant Thornton would like to see the EMDG cap expanded to include businesses with turnover of up to $250 million. Historically and statistically, businesses of this scale have a higher likelihood of success.

We welcome the governments initiative to provide $24.6 million over two year from 2015-16 to promote business understanding of the FTAs and to assist businesses to access and maximise their benefits under these agreements.

International expansion

The cap on Austrade Export Market Development Grants should be increased to include businesses with turnover of up to $250 million.

How far does this budget go towards supporting international expansion?

In an effort to boost Australia's exports, the government has turned its attention to the services sector, specifically higher education, tourism, health care and financial services.

The Federal Government's $6 billion investment in recent trade agreements with China, Korea and Japan (and another coming with India) is critical in levelling the playing field. Government support in operationalising these trade agreements will be vital to best capitalise on the agreements.

Putting in place solid economic and government policy is not enough, however. We also need to significantly improve how we get to market and how quickly. So the announcement of spending on improved freight corridors and the $5 billion Northern Australia Infrastructure fund which will see the Federal Government join forces with state governments in the Northern Territory, Queensland and Western Australia as well as the private sector is welcome news for MSBs. These measures will provide concessional loans to build new ports, pipelines, infrastructure and power projects, and deliver goods and services directly to Australia's northern neighbours.

While there was no movement on the Export Market Development Grant (EMDG) threshold, setting the right policy foundations to open new markets and incentivising the development of export corridors both gain a big tick.

The announcements regarding trade were balanced and should be fundamentally acceptable to both sides of politics. They provide certainty for the export-orientated mid-market. This, in turn, will provide the required investment to build export markets, the fundamental objective of the EMDG program.

Managing talent to support growth

6.6% fewer subclass primary visas were granted in 2014–15 than in 2013–14 due to cumbersome visa processing requirements. This is negatively impacting mid-sized business' ability to access the skilled talent from around the globe they need to grow.

Mid-sized businesses compete with larger, high-profile firms for top talent. But they often have neither the brand recognition nor the mobility specialists to truly compete. What's needed is a flexible and responsive migration visa framework in order to access the depth and breadth of global talent.

Cumbersome visa requirements are negatively impacting mid-sized business's ability to access global talent (6.6% fewer subclass primary visas were granted in 2014-15 than 2013-14).

MSBs, particularly those in the finance and technology sectors, are painfully aware of the mobile and footloose global talent they're potentially missing out on.

Greater efficiency processing business visa applications (from months to weeks) and a review of the labour market requirements and language proficiency tests currently in place are needed.

Better data is also sorely needed to streamline 457 business visa approvals, to inform decisions and enhance service delivery. It would enable more targeted, and therefore better, service delivery, and ultimately, a better program. The questions to ask are: What value is the program delivering? To what companies? What sectors? Where are the outlays? How are we measuring returns?

With the increasing gravitational pull of China's and India's maturing economies, Australia is in danger of dealing itself out of the important market for talent.

Managing talent to support growth

Faster and more efficient processing of business subclass 457 visa applications (reducing the process from months to weeks by selectively increased resourcing).

Why?

How far does this budget go to helping MSBS manage talent for growth?

This budget contains a number of measures to boost workforce participation. $33 million in targeted spending on new job initiative at employers and young job seekers to support the transition to work along with incentives for employers to bring mature aged job seekers back into the workforce. The government will provide $18 million over four years for around 6,000 job seekers annually to undertake valuable work experience for up to four weeks while they continue to receive valuable income support.

The $4.4 billion Families Package is aimed squarely at giving parents "more choice and opportunity to work". This, coupled with mooted reforms to the way in which the $1.2 billion wage subsidy pool is designed and distributed, creates an opportunity to provide a deeper and more diverse talent pool available to the MSBs. A single Child Care Subsidy, based on family income, will replace the Child Care Benefit, Child Care Rebate and Jobs, Education and Training Child Care Fee Assistance programme. It has been broadly welcomed by lobby groups and the legislation should attract sufficient support from cross-benchers to be enacted. Expect the government to make some concessions over its attempt to tie this to the passage of cuts to family tax benefits introduced in the last budget, and still stalled in the Senate.

But there is a sting in the tail for working families. The simplified Child Care Subsidy scheme will not be implemented until 1 July 2017, whereas the removal of "double-dipping" in Parental Leave Pay (PPL) will kick in a year earlier. From 1 July 2016, access to PLP will be limited to individuals whose employer does not provide parental leave entitlements. We fear this will encourage some businesses that currently provide parental leave entitlements to pare back or wind up their schemes in the knowledge that government will top up benefits to their employees. Larger businesses are more likely to maintain generous schemes, with the result that employment opportunities in small and MSBs will become relatively less attractive to would-be parents.

Overall, the changes will result in less money being available for parental leave – a big back flip compared to the $20 billion dollar signature policy on parental leave Mr Abbott took to the last election. That said, the government deserves some credit for adopting a broader approach to boosting workforce participation by also targeting assistance to young job seekers, older workers and long-term unemployed.

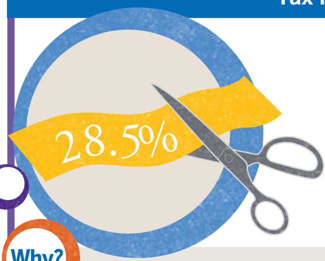
Tax relief

The 30% company income tax rate places an undue burden on businesses with big labour costs, particularly the mid-size business sector.

Australia's current 30% company tax rate perpetuates the competitive disadvantage faced by mid-sized businesses, both in terms of OECD company tax rates and of our nearest trading partners: China, Malaysia and Indonesia (all 25%); Singapore (17%), and New Zealand (28%). The UK has a company tax rate of 21%, reduced from 26% in a staged process from April 2012.

The government has flagged a 1.5% reduction in the company tax rate for small businesses from 1 July, down from 30% to 28.5%.

Tax relief



Reduce company tax to 28.5% to include mid-size businesses.

Why?

How far does this budget go towards achieving tax relief for MSBs?

We welcome the proposed tax relief and concessions announced in the budget papers for small businesses (businesses with less than $2 million turnover) – taking the corporate tax rate down to 28.5% and providing a 5% discount on their business income for unincorporated small businesses. We hope these discounts will "prime the pump" to encourage economic growth for not only small businesses but also for MSBs that service and supply them. We also welcome the initiatives announced to create a more level playing field, in the form of increased action to address the base erosion and profit shifting (BEPS), that will see penalties of 100% of unpaid tax plus interest and the government has 30 multinationals already in it's sightsalong with leveraging of GST on digital supplies, which takes effect from 1 July 2017.

In order to achieve more meaningful tax reform, we would have liked to have seen more uniformity in the tax relief, with a more significant across-the-board reduction in the corporate tax rate, supplemented by a broadening and increase of the GST base and rate. Such a move would not only stimulate the MSB sector, the engine room of our economy, but would also promote a more efficient system of taxation based on consumption and help address the BEPS issue by reducing the attractiveness of offshore tax havens.

We expect that incentives such as the up-front deduction of capital items to the value of $20,000 for small businesses and favourable tax deductions for farmers will create a welcome increase in demand for MSBs that supply them, such as motor vehicle dealers and equipment sellers. This deduction applies on an individual asset basis, and there is no limit on the number of individual assets that the small business can apply this towards. What we would have preferred to see, again, is more uniformity in providing such incentives, and in particular providing MSBs with accelerated depreciation deductions for certain qualifying assets that support their need for innovation.

Access to finance

Mid-size businesses struggle to access finance from lenders, due to a perception that they present a higher risk and operate with more volatile cash flows.

Most MSBs are reliant on banks to fund their investment and growth. Yet they are often misunderstood by lenders, with the common perception being that MSBs present higher risk and more volatile cash flows.

This lack of understanding has led to higher fixed costs – through regulation and taxation – in accessing capital. Some relief from this impost would be a welcome move.

More nimble financing solutions and financiers are required. While the banks argue that higher funding costs and risk assessment of risk justify their higher lending rates (particularly in comparison to the cash rate), alternatives are emerging. David Murray, the head of the Financial System Inquiry, argued recently that supermarkets, with their strong positive cash flows, could provide greater competition in business lending; likewise the peer-to-peer lenders, who offer and very competitive lending rates.

Federal tax incentives for superannuation funds, sophisticated individual investors and government-owned agencies to diversify their portfolios to include MSBs would also be welcome.

Access to finance

Greater access to non-traditional financing options.

Why?

How far does this budget go towards improving MSBs access to finance?

Announced in the Budget last night, Australia will implement and monitor a regulatory framework to facilitate crowd-sourced equity funding, with $7.8 million in funding to be allocated over four years, including $2.6 million for the 2015–16 financial year.

The measures are expected to ease the burden of transitioning to appropriate corporate structures and simplify reporting and disclosure requirements. This will encourage more small businesses to take advantage of crowd-sourcing to fund their start-ups and innovation.

In order to relieve the mid-sized business sector's reliance on traditional sources of financing, we would like to see this initiative expanded beyond small business. In addition to opening up the market for crowd-sourced equity funding, support for measures such as investment by superannuation and pension funds into unlisted MSBs, and innovation in alternative corporate lending sources, such as peer-to-peer lending would also be a welcome move.

In less positive news for MSBs, hidden in depth of the Budget papers was the Government's intention to proceed with last year's budget announcement to reduce the rate of the R&D tax offset by 1.5%. The new rates will be 43.5% for the refundable tax offset and 38.5% for the non-refundable tax offset.

When this was first flagged in last year's budget, the reduction in the rate was linked to the general reduction in the rate of company income tax. With the proposed company tax rate reduction in this year's budget only applying to small businesses, MSBs face a net 1.5% reduction in much needed R&D funding.

Such a move is at odds with encouraging investment in innovation and creating jobs. For companies eligible to receive the refundable offset, the reduction in rate represents a loss of cash, which could be used to fund further investment in innovation.

Other measures impacting mid-size business

Fringe benefits tax

Improving fairness

Currently, FBT concessions are available to not-for-profit and public health sector employees for various entertainment benefits such as meals, alcohol, holiday accommodation and other lucrative benefits. These benefits are neither capped nor reportable for FBT purposes.

The 2015 budget includes measures that introduce a grossed-up cap of $5,000 per year on such entertainment benefits from 1 April 2016 and makes them reportable, whilst other concessions currently available will continue to be accessible to these employees in the future..

Reduced red tape

The Government will reduce red tape regarding the FBT exemption applying to work-related portable electronic devices for small businesses with a turnover of less than $2 million. This will ensure that all work-related portable electronic devices are exempt from FBT for those entities.

Small business concessions

This is the centrepiece of this year's budget. The Treasurer has pinned his hopes on a simple – some might say, simplistic – statement: "Our future growth will come from growing small business into big business". So the government proposes a plethora of small business concessions and incentives to add to those already in existence.

It's a risky proposition. Small business failure rate is and always will be relatively high. It's a worthy objective to seek to reduce this, but it does seem odd that all of the government's limited largesse should be concentrated on businesses that turn over less than $2 million. We would like to see a more balanced approach, with fewer concessions and incentives extended to businesses of larger size. We would like to see a more balanced approach with concessions and incentives extended to MSBs with turnover of between $10 million to $250 million. These MSBs – proven survivors, innovators and employers of large numbers of Australians – are at least as well placed to take advantage of tax relief and reduction of red tape.

On the plus side, the Small Business Package should increase the cash balances of small businesses and thereby create additional demand for goods and services from suppliers of all sizes and in all sectors.

1 **Corporate tax rate**
From 1 July 2015, the company tax rate for small incorporated businesses (annual turnover <$2M) has been cut by 1.5% percentage points, to 28.5%. However, the franking credit rate remains unchanged at 30% which will provide certainty for investors.

2 **Small unincorporated businesses**
For small businesses (annual turnover <$2M) that are unincorporated i.e. the sole traders, partnerships or trusts, they will receive a 5% discount on their business income from 1 July 2015. This discount is viewed to be broadly in line with the 1.5% reduction in the corporate tax rate for such entities that are incorporated. However, this 5% discount will be capped at $1,000 per individual in an income year and provided in the form of a 'tax credit' in their income tax returns.

3 **Asset writeoff / accelerated depreciation**
From 7.30pm AEST on 12 May 2015 up to 30 June 2017, all small businesses (annual turnover <$2M) will be permitted to claim an immediate tax deduction on any individual assets purchased that cost less than $20,000. This deduction applies on an individual asset basis and there is no limit as to the number of individual assets that the small business can apply this towards. These assets can include coffee machines, office equipment, cars and vans.

Assets costing over $20,000 can be 'pooled' and depreciated at the same rate – being 15% in the first income year, and 30% in each subsequent income year.

For this same two year period up to 30 June 2017, the Government has suspended the current "lock out" laws for the simplified depreciation rules (which had prevented small businesses from re-entering the simplified depreciation regime for 5 years if they opt-out).

4 **New Capital Gains Tax relief**
From the 2016-17 income year, a new Capital Gains Tax roll-over relief will be available for small businesses (annual turnover <$2M) that change their legal structures that do not necessarily involve incorporated entities. This is to assist businesses who might find their initial structure to be unsuitable for their needs when their business becomes more established.

5 **Streamline business registrations**
From 2014-15, the Government will provide $32.4 million over 5 years to allow the ATO, ASIC and the Department of Industry and Science to develop a single online portal for businesses. This will help to streamline the business and company registration process.

How does this budget stack up in support of growth for mid-size business?

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