Federal Budget 2016-17

A Business Focus

St.George Economics

May 2016

Outline

- The Federal Government released its Budget for 2016-17 on May 3.
- The deficits in 2016-17 and in following years were revised higher.
- Surplus is not expected till after 2020.
- The move into surplus relies on stabilising commodity prices, a pickup in economic growth and a further decline in the unemployment rate to 5.5%.
- The Budget is not expected to significantly add to or detract from economic growth.

Key Policies Affecting Businesses

Small Businesses

- The small business company tax rate will be cut from 28.5% to 27.5%. It will be available to businesses with turnover less than $10 million from 1 July 2016.
- The accelerated depreciation write off available to businesses with turnover less than $2 million will be extended to businesses with turnover less than $10 million from 1 July 2016.

"Google Tax"

- Introduction of a Diverted Profits Tax to impose a 40% penalty rate of tax on multinational companies that attempt to shift profits offshore to avoid paying tax.

Youth Employment

- Investment of $840mn in a Youth Employment Package, creating a Jobs Programme (PaTH) for training, skills and internship placements.

Big Business

- The company tax rate will be lowered gradually to 25% by 2026-27 for all companies.

Defence

- An additional $29.9bn will be invested in ships and submarines over the next 20 years.

SME Businesses – The Big Winners

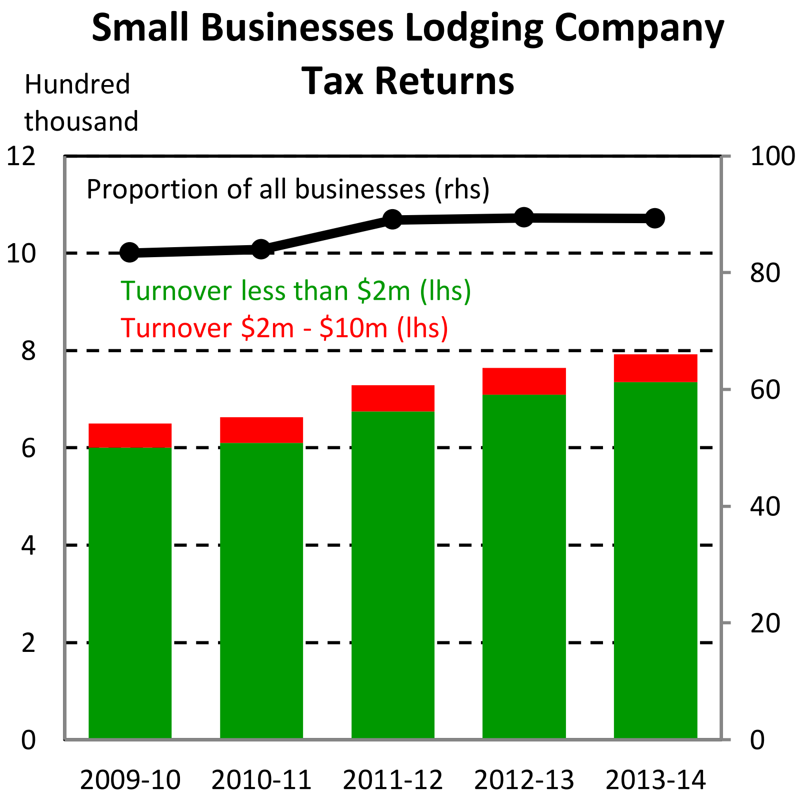
- One of the headline acts was to reduce the micro-company tax rate from 28.5% to 27.5%. This lower tax rate is now available to businesses with turnover of less than $10 million (up from $2 million in last year's Budget). The new rate and threshold will apply from 1 July 2016.

- The unincorporated small businesses small business tax discount will increase gradually over 10 years from 5% to 16%. On 1 July 2016 the tax discount will increase to 8%, up to a total benefit of $1,000 per year. The turnover threshold will increase from $2 million to $5 million from 1 July 2016.

- The immediate tax deduction for assets costing less than $20,000, that was offered to businesses with turnover of less than $2 million in last year's Budget has been extended to businesses with under $10 million turnover. The deduction applies until 30 June 2017.

- Changes to Superannuation potentially benefiting some SME owners include income tax deductions for personal superannuation contributions up to the concessional contributions tax, regardless of their employment circumstances.

What is a "Small Business"?



Source: Australian Taxation Office

- Most benefits are for businesses with under $10 million annual turnover in the 2016-17 Budget, up from $2 million in the 2015-16 Budget.

- The $2 million threshold in last year's Budget would have included around 2 million businesses according to the Council of Small Business Australia (COSBA). The lifting of the threshold to $10 million would cover an additional 100,000 businesses, according to the COSBA, but these are businesses with more employees and more buying power.

- The widening of criteria for measures to accelerate depreciation (to businesses with turnover up to $10 million) could encourage some of these larger businesses to bring forward some investment spending.

Corporate Tax Rate Declining

- A lower corporate tax rate of 27.5% will apply to businesses with turnover under $10 million from 2016-17. This is down from 28.5% previously, for corporates with turnover under $2 million. It is also below the general corporate tax rate of 30%
- The threshold for the lower tax rate will increase in each subsequent year, from $25 million in 2017-18 to $50 million in 2018-19, $100 million in 2019-20, $250 million in 2020-21, $500 million in 2021-22 and $1 billion in 2022-23.
- Then from 2024-25 the corporate tax rate for all businesses will decline further.
- The corporate tax rate will fall to 27% in 2024-25. It will then fall by one percentage point per year, until it reaches 25 per cent in 2026-27.

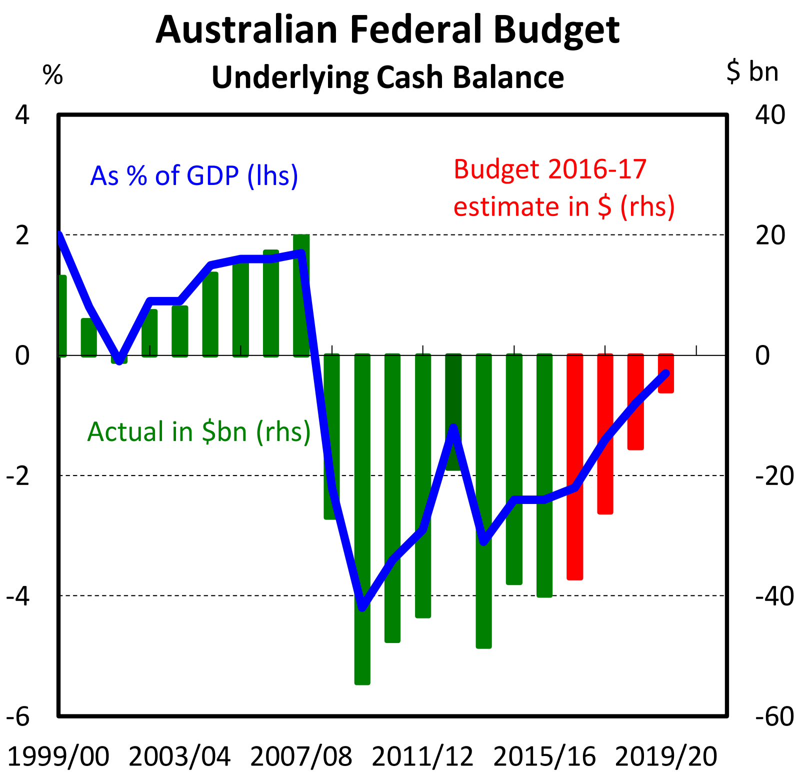
Industry Winners

- **Small Business –** As previously detailed, tax cuts, increased threshold for tax cuts.
- **Security and Defence** – Increased defence spending, with $32.3bn in 2016-17. The Naval shipbuilding strategy includes construction of submarines and patrol boats in South Australia and Western Australia. $1.6bn is budgeted for defence innovation, including $730m for the Next Generation Technologies Fund.
- **Infrastructure** - $2.9bn for new projects, with a focus on Victorian roads and rail, including the Western Ring Road and the Monash Freeway. In other States, there is additional funding for the Perth Freight Link and funding for the Ipswich Motorway.
- **Clean Energy**- The Clean Energy Innovation Fund aims to provide financing to emerging clean energy technologies (worth $1bn over 10 years from existing Clean Energy Finance Corporation funding).
- **Great Barrier Reef** - $171m for Reef Trust and Reef 2050 Plan, from existing resources of the National Landcare Program.
- **Northern Australia Infrastructure Facility** - $43.8m over five years to establish the NAIF, which will deliver up to $5bn in financing over five years to support economic infrastructure in northern Australia.
- **Environment** - $22.6m over three years to Natural Heritage Trust component of the National Landcare Program.
- **Pharmaceuticals** – new PBS listings

Those Losing Out

- **Tobacco –** Four annual increases of 12.5% per year in the tobacco excise from 2017 until 2020. It is estimated this will raise $4.7bn in Budget revenue over the next four financial years.
- **Health** – Extending freeze on indexation of Medicare rebates for two more years (saving $925m).
- **Multinationals** – Introduction of diverted profits tax to impose a 40% penalty rate of tax on multinational corporates that attempt to shift their Australian profits offshore to avoid paying tax. It will apply from July 1, 2017 for large global companies with turnover of $1bn and above.
- **Aged Care** – Changing criteria for how funds are distributed to providers.
- **Training –** The Industry Skills Fund will face cuts of $247m over 5 years.
- **Universities** – Higher Education Reform will be delayed by an additional year, to undergo further consultation.
- **Child Care** – The introduction of the Jobs for Families Package, which includes funding for child care, will be deferred by one year.
- **Online Businesses** – GST will apply to “low-value” goods imported from overseas from companies with Australian turnover of greater than $75k.

The Budget Bottom Line

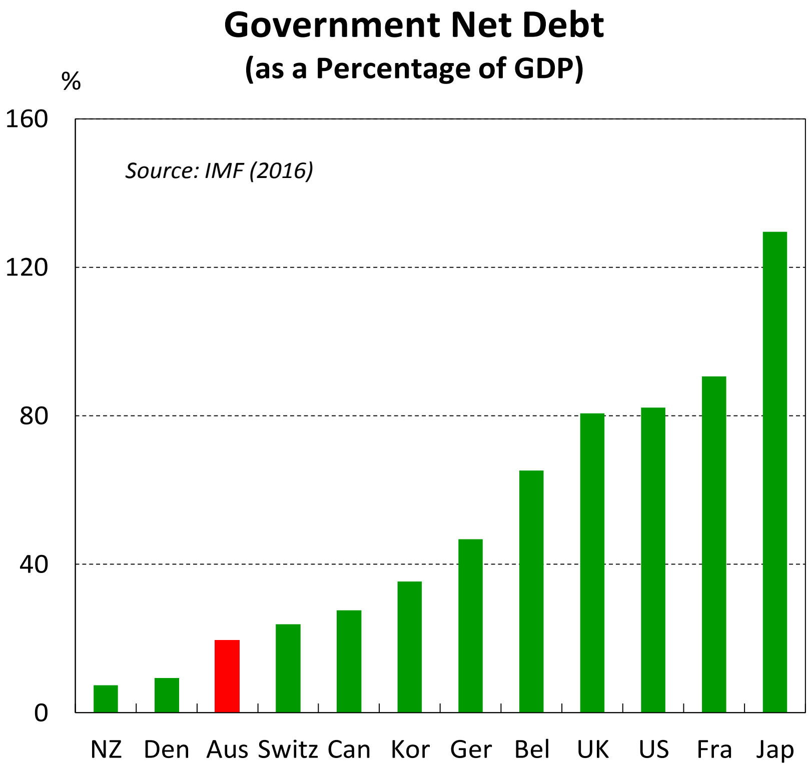


- The Government is expecting a deficit of $37.1bn in 2016-17 after an expected deficit of $39.9bn in 2015-16.

- It is not a “slash and burn” budget, nor is it a “big spending” budget.

- This means that the Budget is not likely to massively add to nor detract from growth.

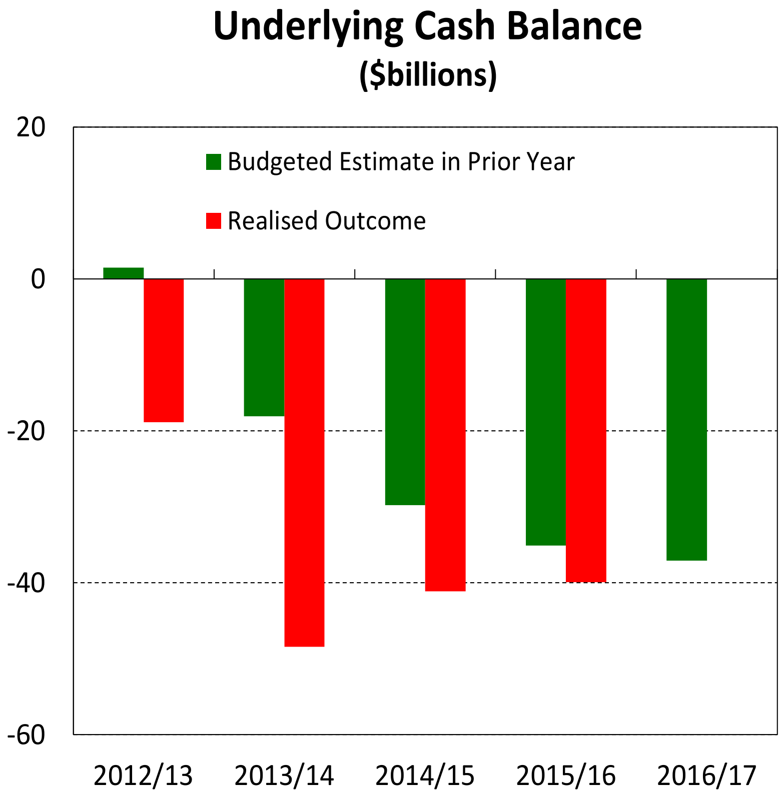
No Need for Urgent Action



- Net debt is expected to now peak at 19.2% of GDP, which is low by international standards.

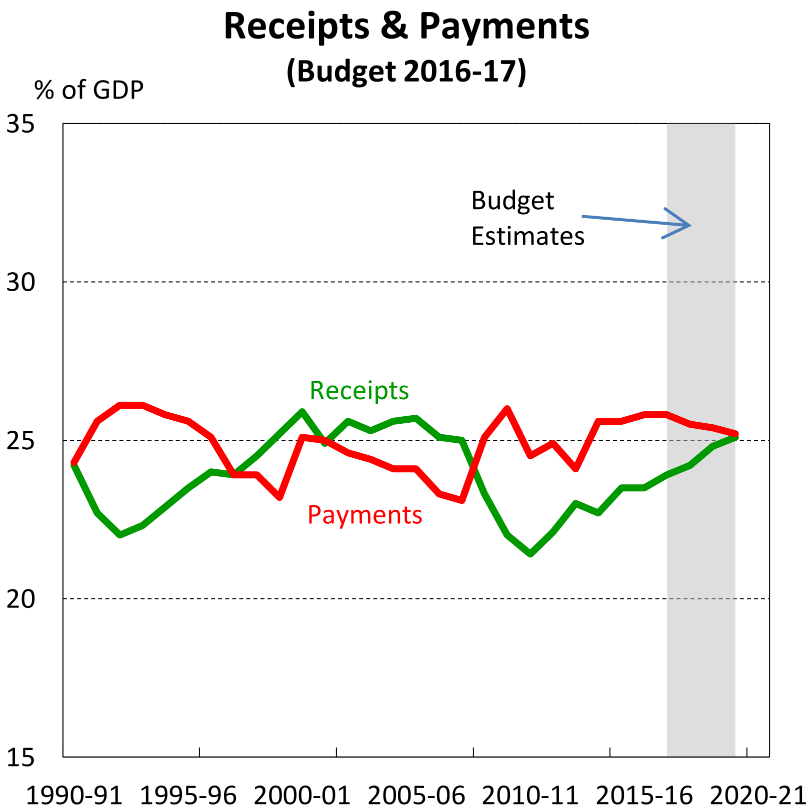
- Structural issues in Australia, such as spending priorities and the shape of the taxation system require resolution in the medium-term.

But It’s a Slippery Slope



- Budget estimates have underestimated outcomes in recent years.

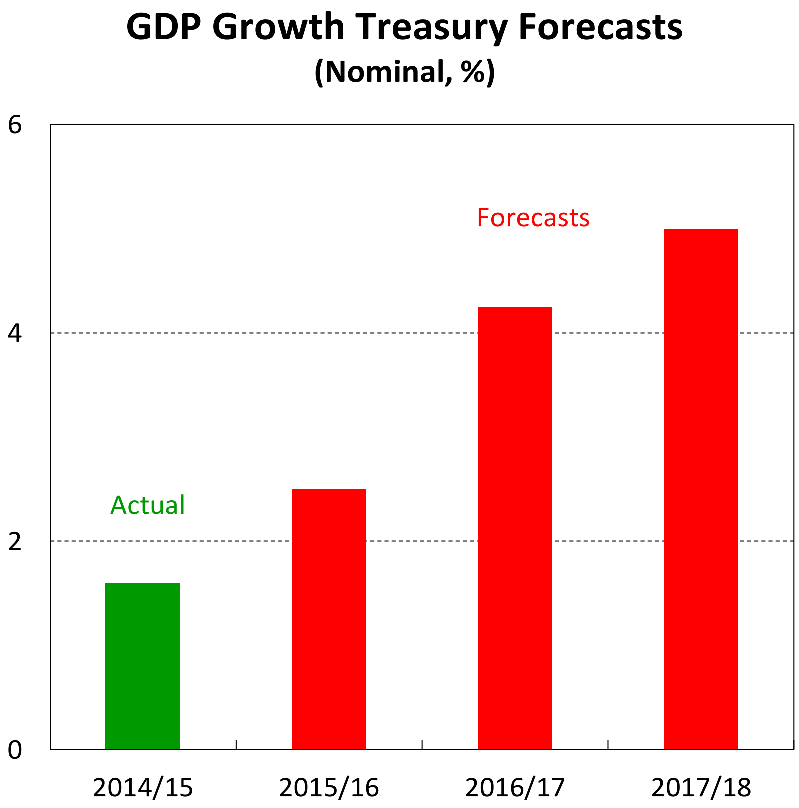
It's not Just a Spending Problem



- In the task of repairing the Budget, revenues should be addressed as well as spending.

- The path to surplus is highly dependent on a pickup in economic growth and incomes.

It’s All About Growth



- Nominal growth forecasts in coming years are conservative and plausible.
- However, narrowing the deficit depends on an expected pick up in growth.

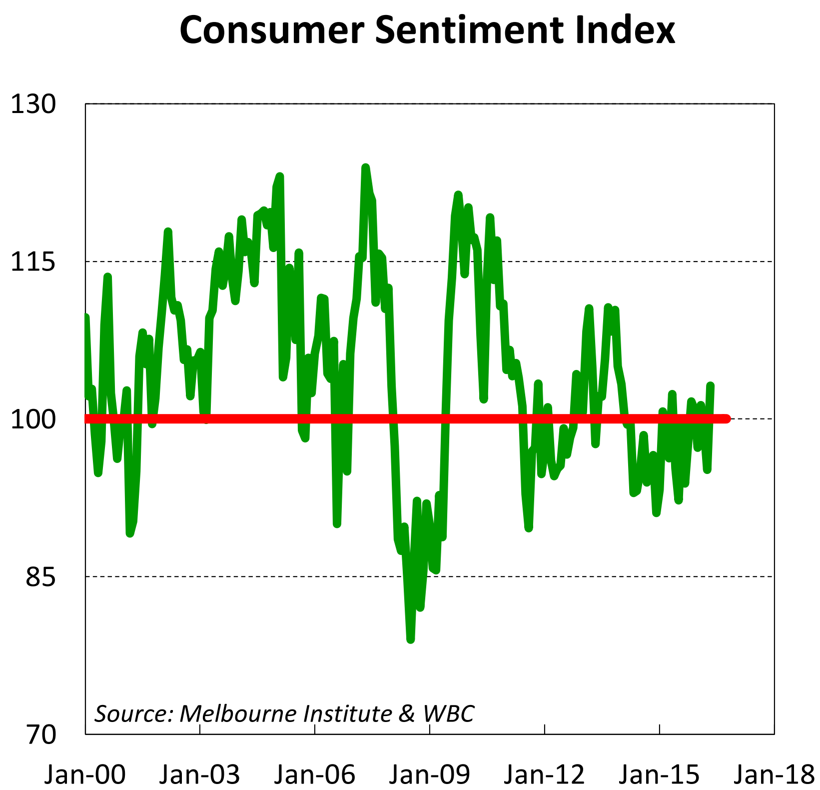
Confidence – Was the Budget Positive?

- In 2014, confidence was dented following the 2014-15 Budget, a pattern which has been observed in previous Budgets. In 2015, an interest rate cut a week before the Budget boosted sentiment. This year the RBA delivered an interest rate cut on the day of the Budget which supported confidence, particularly among consumers.

- The 2016-17 Budget was not one of rapid repair nor sharp cuts to spending, and has probably not been as detrimental to confidence as past Budgets.

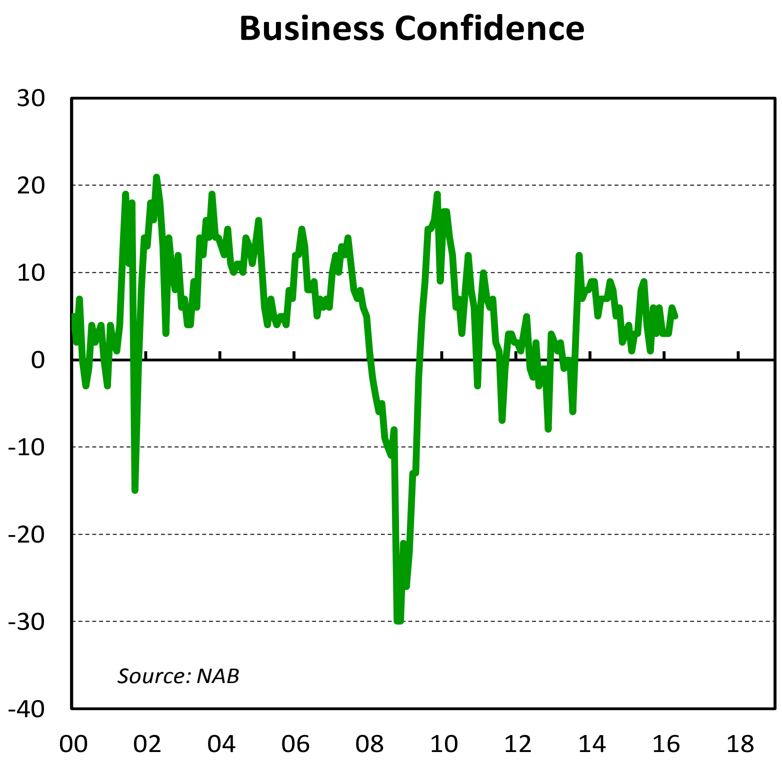
- The upcoming Federal Election on 2 July raises uncertainty regarding the passage of the Budget measures through Parliament. Its outcome is likely to be a longer-term driver of confidence.

Consumer Confidence



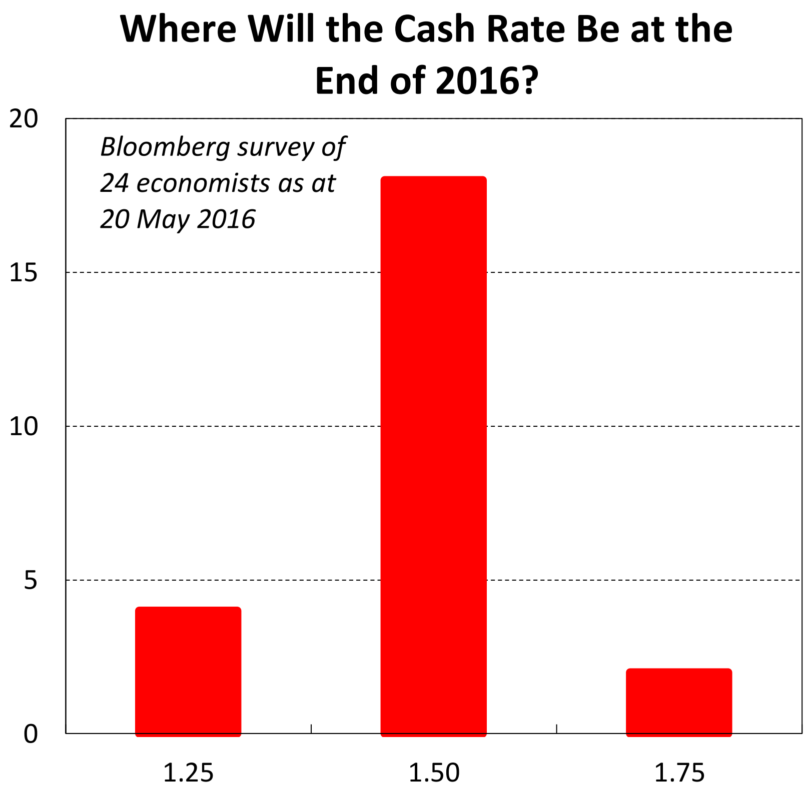
- Westpac-MI consumer confidence jumped 8.5% in May, to a reading above 100 indicating more consumers are optimistic than pessimistic.
- This boost to confidence follows an interest rate cut from the RBA and the release of the Federal Budget on the same day, but the details in the survey suggest the interest rate cut played a larger role in the stronger confidence reading.

Business Confidence



- We are yet to receive an update on business confidence following the Budget, although anecdotal reports suggest businesses have received the Budget favourably.
- In April, business confidence was at a reading of 5, slightly below its long term average (of 6 points).
- Hopefully the increase in consumer confidence in May can be sustained and will feed through to stronger business confidence.
- Following the previous Budget in 2015, NAB business confidence improved, rising from 3 to a reading of 8 in May.

Implications for Interest Rates



- We see limited impact from the Budget on the outlook for official interest rates.

- The outlook continues to be for economic growth around trend over much of 2016. Inflation is currently below the RBA's inflation target band.

- Following an interest rate cut of 25 basis points in May this year (on Budget day), we expect the RBA will cut interest rates again in August.

Long-Run Issues Remain

- Ideally, the Budget should be in balance over the long-run. The Budget is now forecast to return to surplus in 2020, if the projections are to be believed.

- The sustainability of public finances with an ageing population is a key long-term issue.

- The 2016-17 Budget plots a course towards a surplus that relies upon economic growth rather than true Budget repair. It did not really tackle the tough structural issues that were promised when talk of tax reform was in the air.

- In its Pre-election Economic and Fiscal Outlook (PEFO) on May 20th, Treasury indicated that revenue will need to rise as a share of GDP if a budget surplus of one percent is to be achieved by 2026.

- This Budget does not risk Australia’s AAA credit rating. Following the Budget, Moody’s credit rating agency reaffirmed Australia’s credit rating.

Election Ahead

- Prime Minister Turnbull has called an election for 2 July 2016, triggering an eight-week campaign.
- It is a double dissolution election, meaning all the seats in the House of Representatives and Senate will be contested.
- Tax cuts are a focus of the campaign. The Turnbull Liberal-National coalition Budget promises cut tax rates for companies and higher-income earners. The Shorten Labor Party is promising to remove negative gearing for established houses and to halve the capital gains tax discount.
- The latest national opinion poll from Fairfax/Ipsos indicates the Coalition has 51 per cent and Labor, 49 percent, on a two-party preferred basis.

Disclaimer

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