Review of the 2015-16 FEDERAL BUDGET

19 May 2015

Key points for business

The 2015-16 Federal Budget provides stimulus for investment through a range of incentives that are wholly focused on small business. It forecasts ongoing below-trend growth and rising unemployment across the economy in 2015 and 2016. The Budget maintains a commitment to restoring the budget to surplus over the medium term, but does not reach that goal during the forward estimates period (the next four years).

There are clear risks that on its own, this Budget may not provide the lift in business confidence and demand needed to generate the additional investment required to lift productivity and growth and to make substantial inroads into unemployment over the next few years.

The main changes in the 2015-16 Budget for business are:

- **Business tax cuts** and **accelerated tax deductions**, limited to businesses with turnover of less than $2 million, to provide incentives for small businesses to grow, invest and create jobs.
- Measures aimed at **reducing the cost of starting a new business**, including measures to streamline business registration and faster tax write-offs for start-up expenses
- Tighter **anti-avoidance provisions for corporate tax** that aim to improve the fairness of the tax system.
- Extending the GST base to capture a wider range of **online digital products**. This is a welcome move in principle that will level a corner of the consumption tax playing field.
- An **infrastructure program** focused on concessional loans, via the Northern Australia Infrastructure Facility. This will encourage investment in major projects in the North.
- Emphasis on **lifting workforce participation**, including improved availability of childcare and improved incentives for employers to hire new employees.
    - For a number of years Ai Group has argued that **improved access to childcare** is the best way to assist parents with young children re-enter the workforce or extend their participation in paid work.
    - In regard to the offsetting savings under the new approach to the **paid parental leave**, the Government must ensure that new arrangements do not deter businesses from putting in place or continuing to offer their own parental leave schemes. These schemes allow businesses to attract and retain staff while they care for children.
- The **immigration program** of 190,000 for 2015-16 is a little short of businesses ambitions, but the renewed emphasis on the skilled component will help to ensure this is a workable compromise. It is important that eligibility conditions for other visa categories, including working holiday visas and 457 temporary skilled worker visas, are not further tightened.
- The Government will provide an additional $18 million to Austrade over four years from 2015-16 to expand its program of **Australia Week promotional events**.

Major announcements for businesses

In contrast to the wide-ranging 2014-15 Federal Budget, the 2015-16 Budget contained a small number of important measures that will assist business. These measures are mainly in the form of changes to tax rates or tax deduction arrangements, rather than changes to expenditure programs.

Tax cut for small companies and unincorporated businesses

The Government has cut income tax on small business income. Businesses with turnover of $2 million or less will receive an income tax cut from the start of the 2015-16 year.

The company tax rate applying to small companies (incorporated businesses) will fall from 30 per cent to 28.5 per cent. Unincorporated businesses will receive a cut of 5 per cent on tax on their business income, up to a maximum of $1,000 p.a.

There is no cut in tax rates for businesses with annual turnover above $2 million. Cutting the company tax rate for all businesses must remain a high priority for tax reform.

How many businesses and companies will benefit from these tax cuts?

The Budget Papers do not identify the number of companies and businesses that are expected to benefit from these tax cuts, but they indicate that in aggregate, this announcement will save Australian businesses $250 million in the 2015-16 tax year, rising to $950 million in 2016-17 and $1 billion in 2017-18.

Australian Taxation Office data indicate that for the 2012-13 tax year, 854,745 companies reported their income to the ATO. Of these:

- 663,020 companies had a total business income (income from all sources and excluding all expenses) of $1 to less than $2 million (77.5% of the 854,745 companies reporting to the ATO for 2012-13). The ATO classes companies in this income range as ‘micro’. Collectively, they paid $7.3bn in net tax in 2012-13, or 11.4% of all net tax paid by companies in 2012-13.
- A further 118,750 companies reported zero or negative total business income (income from all sources) in 2012-13 (13.9% of all companies) but nevertheless paid $113 million in net tax. These companies might benefit from this tax cut if their turnover size is assessed as being under $2 million.
- Around 72,975 companies had total business income (from all sources) of $2 million or more in 2012-13 (8.6% of all companies reporting to the ATO in 2012-13). Collectively, these companies paid $57 billion in net tax in 2012-13, or 88.4% of net tax paid by companies in 2012-13. These larger companies will not benefit from these new tax cuts.

The number of small unincorporated businesses (registered businesses that are not companies) and the amount of tax paid by them is less easy to identify from ATO data or other sources. The ABS business register indicates that in June 2014 there were 2,100,162 active businesses registered in Australia. This includes businesses that are incorporated (companies), unincorporated, sole proprietors, partners and trusts. Of these 2.1 million active businesses:

- 1,964,884 businesses (93.5%) had a turnover of less than $2 million in 2013-14,
- 137,278 businesses (6.5%) had a turnover of $2 million or more in 2013-14.

These 1.9 million businesses with turnover under $2 million in 2013-14 include all companies of this size. So, based on the ATO data noted above (781,770 companies reporting income of zero or up to $2 million in 2012-13), this implies there are around 1.2 million Australian businesses of this size that are unincorporated, sole proprietors, partnerships or trusts, accounting for 60% of businesses of this size. These 1.2 million businesses will be able to claim the 5% discount on their business income from the 2015-16 tax year, up to a maximum benefit of $1,000 per business.

Table 1: Estimated number of Australian businesses and companies, by size

Australian business registrations, June 2014	**Businesses**			
Annual turnover range	*number*	*%*		
Zero to less than $50k	555,606	26.4		
$50k to less than $200k	722,565	34.4		
$200k to less than $2m	686,713	32.8		
$2m or more	135,278	6.4		
All businesses	**2,100,162**	**100.0**		
Australian companies reporting to ATO, 2012-13	***Companies***		***Net tax paid***	
Total business income	*number*	*%*	*$mn tax*	*%*
Loss (less than $0)	1,740	0.2	7	0.0
Nil (equal to $0)	117,010	13.7	113	0.2
Micro ($1 to less than $2 million)	663,020	77.6	7,371	11.4
Small ($2 million to less than $10 million)	55,700	6.5	6,558	10.2
Medium ($10 million to less than $100 million)	14,965	1.7	8,177	12.7
Large ($100 million to less than $250 million)	1,220	0.1	3,030	4.7
Very large ($250 million or more)	1,090	0.1	39,274	60.9
All companies	**854,745**	**100.0**	**64,530**	**100.0**

Sources: ABS *Counts of Australian businesses*, Jun 2010 to Jun 2014; ATO, *Taxation Statistics,* 2012-13.

Improved tax deductions for all small businesses, until 30 June 2017

The budget introduces an **instant tax write-off facility** for all small businesses between now and 30 June 2017. Business entities, including sole traders, with turnovers of $2 million or less will be able to claim a deduction for the full value of any asset worth up to $20,000, in the year in which the investments are made. This will lift the net present value of depreciation allowances, boost cash flows, and reduce compliance costs for eligible businesses.

This measure will save businesses an estimated $250 million in 2015-16, rising to $800 million in 2016-17 and $850 million in 2017-18. It is currently scheduled to end on 30 July 2017 (the date on which assets are purchased). In subsequent years, the measure will boost tax collections because deductions that would otherwise have been claimed in these years will not apply (having already been claimed prior to 30 July 2017).

Improved FBT treatment for electronic devices purchased by small businesses, from 1 April 2016

From 1 April 2016, small businesses (with annual turnover under $2 million) will be exempt from Fringe Benefits Tax (FBT) when purchasing **any portable electronic device** for their business, even where multiple devices have substantially similar functions. This will include laptops, tablets, phones and all handheld computing devices. Currently, the FBT exception is available for one device per employee only, with subsequent devices that are deemed to perform a “substantially similar function” attracting an FBT liability. This measure is intended to remove complexity and confusion regarding FBT liabilities on such devices and is expected to save businesses only a “small but unquantifiable” amount of tax. This measure will, nevertheless, be most welcome for businesses wishing to simplify their tax liabilities.

Improved tax deductions for start-up business expenses

Measures aimed at start-up businesses in this year’s Budget include:

- streamlined business registration. In an effort to reduce the effort required to register a new business or company, these administrative processes will be combined into a new online portal service that can register both businesses and companies, to be run by ASIC;
- allowing immediate deductions for certain start-up expenses. From 1 July 2015, businesses will be able to immediately deduct professional expenses associated with starting a new business, instead of deducting them over five years. The Government estimates this will save new businesses $10 million per year;
- removing tax barriers to small business restructuring. Small businesses will be able to change their legal structures without attracting a capital gains tax liability. This will come into effect from 1 July 2016 and will save businesses an estimated $20 million per year; and

These are sensible initiatives. They should boost new business creation; reduce regulatory burdens; give business owners more time to spend on their businesses; and generate new opportunities for growth.

Other business tax measures that will affect some businesses

The Budget contained measures to tighten the **anti-avoidance provisions**, which have the potential to improve the fairness of the tax system. It will be critical that these measures are designed and implemented in consultation with business and in a way that does not detract from incentives to invest in Australia and do not create additional uncertainty for business. The decision not to proceed with a new Diverted Profits Tax is particularly welcome. It recognizes the fundamental strength of the structure of Australia's international tax arrangements and avoids the substantial risk of a further complication of Australia's already overly-complex business tax system.

The extension of the GST base to capture a wider range of **online digital products** is a welcome move in principle that will level a corner of the consumption tax playing field. There is clearly much further to go in this regard and a broadening of the consumption tax base should be a major part of upcoming tax reform measures. Careful attention will need to be given to the design of new measures and consultation with business will be a key in part in getting it right.

Infrastructure announcements

In contrast to last year's Budget where the $11.6 billion Infrastructure Growth Package was the centrepiece of the Budget, the 2015-16 Budget focused on a **Northern Australia development package**, most of which does not affect the Budget bottom line. The main component of the Northern Australia development package is $5 billion of concessional loans that the Government will provide with the "objective of increasing private sector investment in infrastructure in northern Australia". Applications will open in 1 July 2015. More details on the administration of these loans will be announced when the Prime Minister releases the Northern Australia White Paper in June.

Other announcements in the infrastructure sections of the Budget include:

- $499.1 million in 2014-15 towards projects in **Western Australia**.
- Extension of the **Tasmania Freight Equalisation Scheme**.
- $1.5 billion savings to the Government over the forward estimates from taking back the funding for the **East-West Link** in Melbourne. But the Federal Government said it remains committed to building the East-West Link in the future but would redirect the funds if the Victorian Government proceeded with “a significant project of national importance”.
- The Government is investing $255 million in a **digital transformation agenda**, to be led by the Digital Transformation Office, to transform the way public services are designed and delivered, making them simpler and easier to use.

Immigration

This year's Budget announced the 2015-16 immigration program at **190,000 migrants**. This was a little short of businesses ambitions, but the renewed emphasis on the skilled component will help to ensure this is a workable compromise.

It is important that eligibility conditions for other visa categories, including working holiday visas and 457 temporary skilled worker visas, are not further tightened. This Budget removed working holiday-makers eligibility for the tax-free threshold, which may have an impact on labour supply from this group in some locations.

Trade-related programs

The Government will provide an additional $18 million over four years from 2015-16 to Austrade to expand its current programme of **Australia Week events**. The events will be held in China, India, ASEAN countries and the United States to build Australia's reputation as a tourism destination and as a trade and investment partner.

Offsetting this increase, the Budget did not to commit to further funding of the **Asia Business Engagement Plan**, beyond its current expiry date of 30 June 2016. All payments that have already been approved under this Plan will be honoured.

Automotive industry adjustment measures

This year's Budget restored funding to the **Automotive Transformation Scheme** after the $500 million cut announced in last year's Budget. However, in reality the net impact of this measure is $105 million, with the Budget papers arguing that cease production in Australia by the end of 2017 have reduced demand for the Automotive Transformation Scheme by $795 million over seven years from 2014-15.

The Budget included no other measures to assist businesses or employees with the transition out of automotive assembly production.

Cooperative Research Centres

Funding for Cooperative Research Centres will be reduced by $26.8 million over four years from 2015-16. Funding of $732.4 million has been earmarked over the forward estimates pending the outcome of a review announced by the Minister for Industry and Science on 16 September 2014.

Entrepreneurs' Infrastructure Programme

Small savings have been taken from the **Entrepreneurs' Infrastructure Programme** of $27.3 million in savings over five years, from 2014-15. These savings arise from the implementation of the Single Business Service and Business Management initiatives under the Entrepreneurs' Infrastructure Programme, with the majority of savings to be realised in the current year.

Workplace skills

The Federal government did not make any major announcements or adjustments to the Commonwealth budget in relation to education and training compared with previous years.

- The **Industry Skills Fund** increases to $164mn this year, with a total of $476mn over four years. There is an expectation that this scheme will support 38,000 participants in the next financial year, rising to 46,000 in 2018–19.
- The new **Australian Apprenticeships Support Network** receives just over $200mn, as part of this program roll-out.
- The **Australian Apprenticeship Incentive Programme** peaks with $435mn this financial year and is expected to support 78,000 employers.
- **Trade Support Loans** will be available to assist 74,500 Australian Apprentices in the next financial year and rising to a projected 90,000 in 2018-19.
- The new **Australian Industry and Skills Committee** will receive around $1.4mn p.a. for the next four years.
- A **National Foundation Skills Strategy** was introduced in 2012, for the next decade. This Budget allocates it just $131,000, with no financial commitment beyond this. This represents a significant reduction in commitment to foundation skills by the government.

Higher Education

This budget sets out the following initiatives for the Higher Education sector:

- An additional year's funding for the National Collaborative Research Infrastructure Strategy (NCRIS) ($150 million).
- One year's additional funding for the Australian Synchrotron.
- An additional $16.9 million from 2015–16 to 2018–19 to enable the Australian Government to raise student learning outcomes through lifting the quality of initial teacher education in Australia. Funding will be directed to support activities to improve initial teacher education courses in Australia.
- A cut of $263 million to the Sustainable Research Excellence (SRE) program. This reduction comes on top of substantial cuts to research block grants over the past three years. In 2012, $500 million over four years was stripped from the SRE program. This was followed by a further reduction of $150 million through the application of the efficiency dividend to all research block grant programs announced in the 2013-14 Budget, plus a cut of $170 million to the Research Training Scheme in 2014-15.
- A proposed cut of 20 per cent to funding for teaching and learning announced in last year's budget remains in this budgeted period and in the forward estimates.

- No funding for The Office of Learning and Teaching to the university sector. Instead, universities will be invited to bid for housing a new program initiative.
- Students who move overseas and reach the minimum income thresholds will have to repay their HELP debt. This is expected to generate an additional $36 million over four years.

Mature-age workers

Employers who hire an **eligible worker aged over 55 years** through the 'Restart Allowance' scheme will now be able to claim the full $10,000 subsidy after one year, rather than waiting for up to two years. This program was part of last year's Budget and replaced the mature worker tax offsets that employees had previously received through the personal income tax system.

Defence investment

There were no new investments or spending announcements (increases or cuts) for the Defence portfolio this year.

Childcare and Paid Parental Leave (PPL) scheme

The Budget this year sets out a number of changes to childcare, PPL and family benefits, which are contingent upon offsetting savings to family benefits being passed by Parliament. The proposal for childcare and PPL benefits includes:

- The Government will provide an additional $3.2 billion over five years from 2014-15, with a new **single Child Care Subsidy (CCS)** to be introduced on 1 July 2017. Families meeting the activity test with annual incomes up to $60,000 (2013-14 dollars) will be eligible for a subsidy of 85 per cent of the actual fee paid, up to an hourly fee cap. The subsidy will taper down to 50 per cent for eligible families with annual incomes of $165,000. The CCS will have no annual cap for families with annual incomes below $180,000. For families with annual incomes of $180,000 and above, the CCS will be capped at $10,000 in benefits per child per year.
- A two year pilot program for an **Interim Home Based Carer Subsidy Program** will trial subsidised care provided by an approved and qualified nanny in a child's home from 1 January 2016. The pilot program will fund approximately 4,000 nannies to care for approximately 10,000 children from 1 January 2016. The trial will be initially targeted at children with disabilities and the families of essential service workers (nurses, fire, police and ambulance) with incomes under $180,000.
- The Government will no longer pay the existing **paid parental leave scheme** of 18 weeks at minimum wage to parents who also receive employer-based schemes.

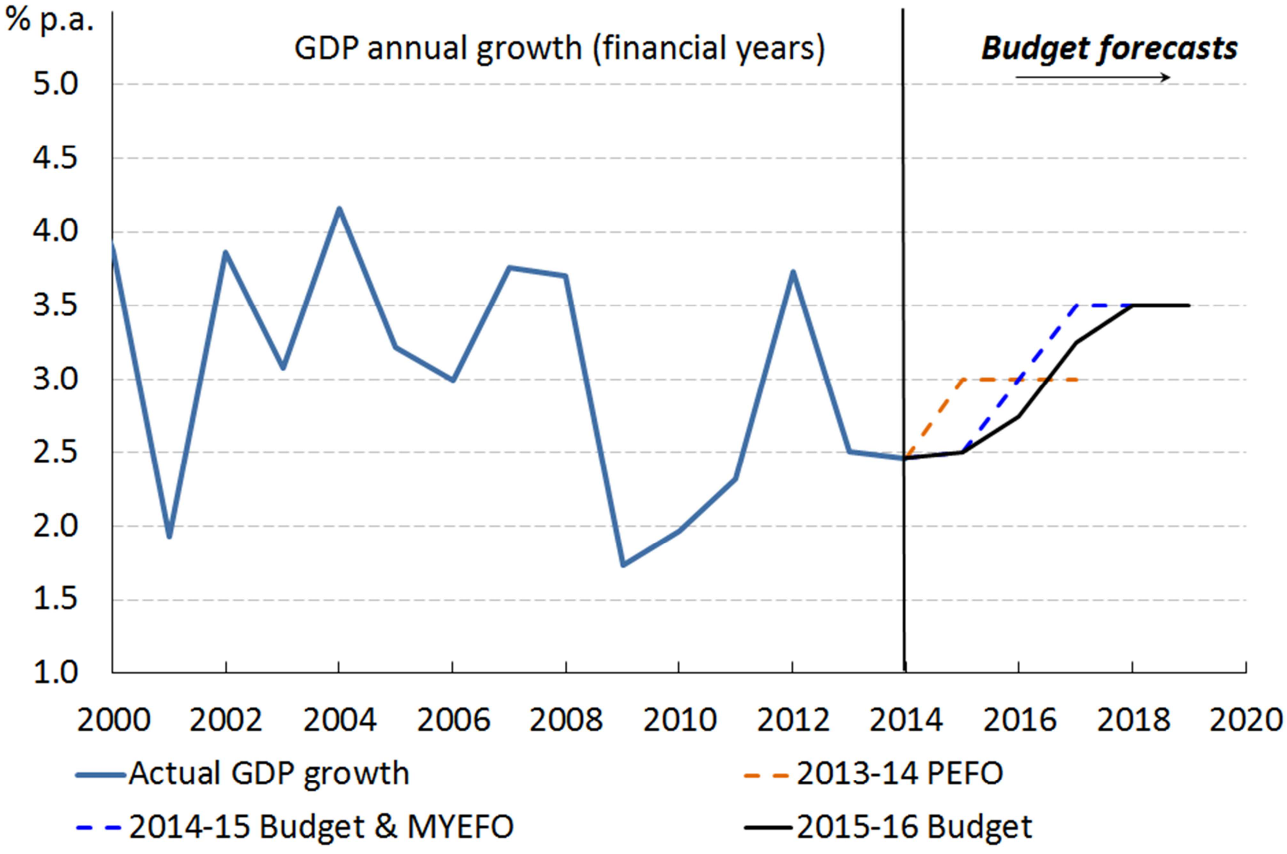
Economic and Fiscal Outlook

The economy

The Budget expects Australia will see below-trend growth and rising unemployment through until 2016-17 (Table 2 and Chart 1). **Real GDP** is expected to grow by 2.5% in the current financial year. This is below the long-term average and below 'trend' growth (that is, the rate of growth required to keep the unemployment rate stable) which is currently considered to be around 3% for Australia.

Weak GDP growth will continue into 2015-16, when growth is expected to firm slightly to 2.75% in 2015, before strengthening to 3.25% in 2016-17. These forecasts for headline GDP growth are weaker than those forecast in last year's 2014-15 Budget and in the Mid-Year update in December.

Chart 1: Australian GDP growth, actual and Budget forecasts



This acceleration depends on house construction growing strongly for the next two years, followed by a recovery in non-mining business investment in 2016-17. The key risks to this outlook are:

- **Housing construction**, which is being supported by low interest rates, may slow. While it is true there is pent-up demand in some places, particularly Sydney, we have already seen several years of strong growth in housing construction, so the forecast of relatively strong growth again (another 6.5% in both years) in 2015-16 and 2016-17 appear optimistic.
- The expectation of a recovery in non-mining **business investment** in 2016-17, the very same year that auto assembly is ending.
- **Commodity prices** and especially **iron ore prices**, which still dominate the outlook for the Australian economy. In this year's Budget Papers, Treasury has estimated that every $10 change in iron ore prices means a 3% change in our terms of trade and a massive 0.8% change in nominal GDP. Nominal GDP is expected to grow by just 3.25% next year, so if iron falls to $38 per tonne instead of the $48 per tonne that has been assumed, then a 0.8 percentage-point change would lower nominal growth to just 2.45% p.a., which is even lower than the weak growth rate already experienced in 2013-14 and 2014-15.
- **The Australian dollar** is assumed to stay around its current level of US 77 cents over the outlook period, but it could easily rise again, due to international and especially US economic events (e.g. if the US dollar weakens because the US economy fails to grow as well as expected). If the Australian dollar rises, this would make it harder for non-mining business growth to recover, particularly in the tradeables sectors (exporters and those that compete with imports). A higher dollar could hamper local business confidence and threaten then non-mining business investment recovery in 2016-17, as forecast in the Budget.

On the **labour market**, below-trend GDP growth for the current and next financial year is not enough to make significant inroads in the unemployment rate, which will continue to rise to 6.5% by 2015-16, a higher peak than previously forecast in last year's Budget by the Treasury of 6.25%.

Wages are expected to grow by 2.5% in this financial year and next, slightly higher than the 2.2% rise recorded over the year to March 2015, which was released this week. Weaker-than-expected nominal wages growth presents yet another risk to the outlook and especially to nominal GDP growth. If wages and incomes growth weakens, than household consumption and income tax collections may weaken also, which would affect the Government's ability to achieve its revenue growth targets.

Table 2: Major economic forecasts

	Outcomes(b)	Forecasts		
	2013-14	2014-15	2015-16	2016-17
Real gross domestic product	**2.5**	**2 1/2**	**2 3/4**	**3 1/4**
Household consumption	2.2	2 3/4	3	3 1/4
Dwelling investment	5.1	6 1/2	6 1/2	4 1/2
Total business investment(c)	-5.1	-5 1/2	-7	-3 1/2
By industry				
Mining investment	-7.0	-15 1/2	-25 1/2	-30 1/2
Non-mining investment	-3.7	2	4	7 1/2
Private final demand(c)	0.9	1 1/4	1 1/4	2 1/4
Public final demand(c)	1.6	1 1/4	1 1/2	1 1/2
Change in inventories(d)	-0.3	0	0	0
Gross national expenditure	0.7	1 1/4	1 1/2	2 1/4
Exports of goods and services	5.8	6 1/2	5	6 1/2
Imports of goods and services	-1.9	-3	-1 1/2	2 1/2
Net exports(d)	1.6	2	1 1/4	1
Nominal gross domestic product	4.0	1 1/2	3 1/4	5 1/2
Prices and wages				
Consumer price index(e)	3.0	1 3/4	2 1/2	2 1/2
Wage price index(f)	2.5	2 1/2	2 1/2	2 3/4
GDP deflator	1.5	-1	1/2	2 1/4
Labour market				
Participation rate (per cent)(g)	64.6	64 3/4	64 3/4	64 3/4
Employment(f)	0.7	1 1/2	1 1/2	2
Unemployment rate (per cent)(g)	5.9	6 1/4	6 1/2	6 1/4
Balance of payments				
Terms of trade(h)	-3.7	-12 1/4	-8 1/2	3/4
Current account balance (per cent of GDP)	-3.1	-3	-3 1/2	-2 3/4

(a) Percentage change on preceding year unless otherwise indicated.
(b) Calculated using original data unless otherwise indicated.
(c) Excluding second-hand asset sales from the public sector to the private sector.
(d) Percentage point contribution to growth in GDP.
(e) Through-the-year growth rate to the June quarter.
(f) Seasonally adjusted, through-the-year growth rate to the June quarter.
(g) Seasonally adjusted rate for the June quarter.
(h) The forecasts are underpinned by spot prices of $48 ($US/t, FOB) for iron ore; $90 ($US/t, FOB) for metallurgical coal and $60 ($US/t, FOB) for thermal coal.

Note: The forecasts for the domestic economy are based on several technical assumptions. The exchange rate is assumed to remain around its recent average level — a trade-weighted index of around 64 and a $US exchange rate of around 77 US cents. Interest rates are assumed to move broadly in line with market expectations. World oil prices (Malaysian Tapis) are assumed to remain around US$64 per barrel.
Source: ABS cat. no. 5204.0, 5206.0, 5302.0, 6202.0, 6345.0, 6401.0, unpublished ABS data and Treasury.

Where is the budget going?

On the fiscal outlook, the budget deficit is headed in right direction over the medium-term, but the Budget will remain in deficit over the next four years, with a small surplus forecast for 2019-20.

Government revenue as a proportion of GDP is forecast to rise over the medium-term in each year, from 22.8% in 2013-14 to 25.2% by 2018-19. In dollar terms, revenues will lift by over $100 billion from $360.3 billion in 2013-14 to $488.2 billion in 2018-19.

The ratio of **Government expenditure** to GDP is expected to fall from 25.9 per cent to 25.3 per cent over the forward estimates period. This is higher than in MYEFO and in last year’s Budget owing to slower-than-anticipated nominal GDP growth over the forecast period. The ratio is projected to stabilise over the medium-term at 25.4 per cent of GDP in 2025-26, highlighting the need to do more to bring spending down over the medium-term.

This combines to leave the **underlying budget balance** $3.9 billion worse off in 2015-16 compared with the last estimate in the MYEFO. It is now forecast to be a $35.1 billion deficit, which is 2.1% of GDP.

Over the next four years, the ongoing deficit is adding another $69 billion to our national debt. As a result, **net debt** will now peak at 18% of GDP in 2016-17, up from 14% in last year's budget.

Commonwealth Government Securities on issue are expected to rise to $573 billion by 2025-26, compared to the $389 billion forecast for 2023-24 predicted last year. These deficit and debt numbers are still predicated on significant reforms from last year's budget being passed.

Some of last year's stalled measures were removed in this year’s Budget such as the Paid Parental Leave scheme as well as overall corporate tax cut to all businesses. These decisions improved the Budget by $10.4 billion over the forward estimates which were offset by $8.82 billion cost of the decision not to proceed with policies contained in last year’s Budget including the GP co-payment and six month waiting period on the Dole for young people. Taken together, the net impact overall was a $1.6 billion improvement in the Budget. Other changes to higher education and cuts to state and territories’ payments are yet to be legislated but remain in the Budget.

Chart 2: Underlying cash balance, successive Budget estimates

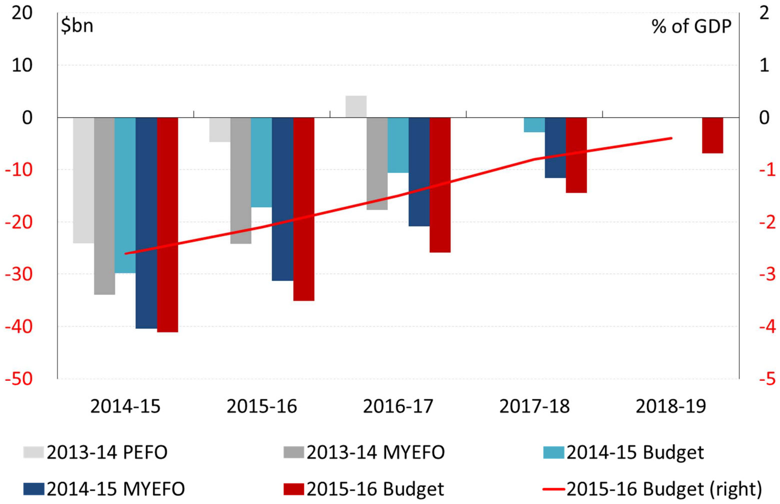
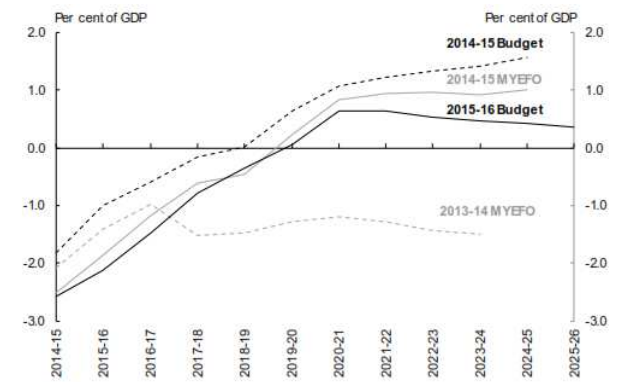
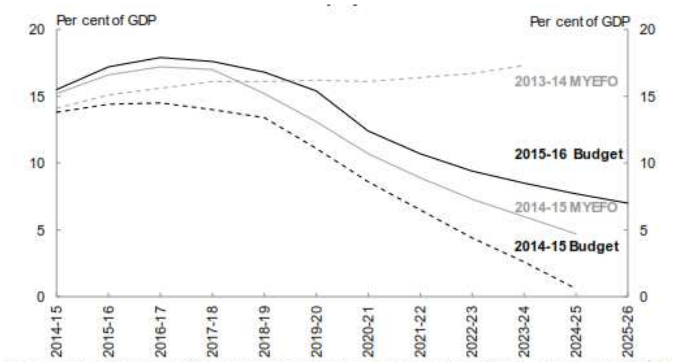


Chart 3: Fiscal balance, projected to 2025-26



Note: A tax-to-GDP cap of 23.9 per cent is applied to these projections from 2020-21, except for the 2013-14 MYEFO where the tax cap applies from 2019-20. 2013-14 MYEFO projections were not originally published with a tax cap. Net Future Fund earnings are included in projections of the underlying cash balance from 2020-21 when drawdowns from the Future Fund commence. The projections of the underlying cash balance originally published in the 2013-14 MYEFO, the 2014-15 Budget, and the 2014-15 MYEFO did not include net Future Fund earnings.

Chart 4: Net debt, projected to 2025-26



Note: A tax-to-GDP cap of 23.9 per cent is applied to these projections from 2020-21, except for the 2013-14 MYEFO where the tax cap applies from 2019-20. 2013-14 MYEFO projections were not originally published with a tax cap.
Source: Treasury projections.

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