Working for business.
Working for Australia

2018-19 Budget Summary

Tuesday, 8 May 2018

Australian
Chamber of Commerce
and Industry

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1. Summary

While there are some positive announcements in this budget, we remain concerned that the government's forecast return to surplus rests on optimistic revenue and payments forecasts. Consequently, the projected surplus might be difficult to sustain. This in turn puts at risk some of the government's key policy announcements such as the 7-year Personal Income Tax Plan, the bulk of which is due from 2020-21.

The reason these are at risk, is because not enough has been done to address structural budget repair. Remember that most of the improvement in the Budget to date and even the return to surplus by 2019-20, is driven largely by a lift in revenue and reduced payments from a strong economy. The growing tendency for government to take infrastructure 'off-budget' (spending that doesn't appear in the headline government accounts) is also assisting.

Our concern is that there is no buffer should the global or domestic economic outlook prove weaker. The International Monetary Fund for instance, forecast a material decline in Australia's economic growth by 2023.

2. Fiscal strategy

The 2018-19 Budget projects government receipts to rise by $109 billion over the four years to 2021-22 (growth 5.6% per year on average), while government payments are projected to increase by $78 billion (growth of 4% per year on average).

On this basis, the budget is now expected to reach a modest surplus of $2.2bn in 2019-20 (0.1% of GDP) which rises to $16.6bn (0.8% of GDP) in 2021-22. At the mid-year economic review in December the government forecast a surplus of $10.2bn or 0.5% of GDP by 2020-21.

The strengthening economy raises $31.5 billion in new taxes and levies over the next four years, while policy decisions reduce receipts by $13.9 billion over the same period. The stronger economy al leads to a reduction in payments of $3.6 billion over the four years to 2021-22, while new policy decisions reduce sending by $404 million.

Net debt is forecast to peak in the 2018-19 year at $349.9 billion (18.4% of GDP), before falling to $319.3 billion in 2021-22 (14.7% of GDP).

Key announcements

There are some welcome aspects to this Budget for business including some that were in our Pre-Budget Submission (in bold).

- **The government will stay the course on tax cuts for business of all sizes**
- **The Budget is expected to return to surplus** by 2019-20**.**
- **Personal tax cuts** – 7-year Personal Income Tax Plan (more details below).

- **Extension of the instant asset write-down** for assets less than $20,000 for a further 12 months only.
- **Net debt is forecast to decline** (more modestly than we would like)**.**
- Maintained the Medicare levy at 2%.
- The National research Infrastructure Investment Plan, which invests $1.9 billion over 12 years to support the research sector.
- **The continued focus on infrastructure spending for the States.** The Budget allocates $24.5 billion to new projects. This is not new spending however. While the projects are new, the $24.5 billion comes out of the $75 billion that was announced last budget.
- The Budget funds $30 billion in a new 5-year public hospital agreement – between 2020-21 and 2024-25.

Less welcome is the way that the government has targeted the research and development tax incentive. Our concerns is that it may disincentivise legitimate R&D activity. (Details below).

While there are certainly positives in tonight's budget, there is little evidence of genuine structural budget repair. This is a significant omission, is something that the business community has called for and an action that some polls suggest has broad community support.

Without structural budget repair, the risk is that the forecast surplus won't be sustained – especially beyond 2021-22. In effect, the government is forecasting a lot to go right and not much to go wrong.

To see this, remember that most of the improvement in the Budget to date and even the return to surplus by 2020-21, is driven by a lift in revenue. The growing tendency for government to take infrastructure 'off-budget' (spending that doesn't appear in the headline government accounts) is also assisting.

Indeed we would highlight that a broader measure of fiscal health, the non-financial public sector accounts fiscal balance, suggests the budget deficit will be materially larger in 2018-19 at $19.4 billion, compared to the headline deficit of 7.4 billion (fiscal balance) and 2.4 billion (operating balance).

The problem with the current strategy, is that the current lift in revenue has been helped by temporary factors. This includes a renewed surge in commodity prices, strong jobs growth and bracket creep - all underpinned by a fairly benign global and domestic economic environment.

We are not questioning the economic outlook as such, in general the government's economic forecasts appear quite reasonable (growth broadly at 3% from 2018-19). The government's revenue forecast includes an expectation of wage growth of 3¼ % by 2019-20 and 3½ % (by 2020-21) which underlines the importance of ensuring that the Australian economy becomes more competitive.

We remain concerned that there is little buffer should the global or domestic economic outlook prove weaker. The International Monetary Fund for instance, forecast a material decline in Australia's economic growth by 2023. If that is the case then revenue growth could be markedly lower and payments growth higher.

The government will need to keep a weather eye on the prospect of strengthening headwinds. These include:

- Rising global and domestic interest rates.
- Peaking global growth and the prospect of a slowdown.
- Growing threat of trade protectionism.
- Heavily indebted consumers.
- Prospect of more subdued conditions in the property market.
- Question marks over the strength of the rebound in non-mining investment.
- The prospect of worsening drought.
- Limited capacity for either monetary or fiscal policy to respond to a downturn.

Instead, the projections for a surplus rest on the assumption that the economy grows at a faster than potential rate over the projection period (and again over the 5 years from 2020-21), with an unemployment rate at 5¼ % (from 2018-19) and labour productivity growth of 1.6% pa.

The implications of this are:

- The announced tax cuts would come under pressure (whether in part or full) if the budget itself comes under pressure from a slowing economy and slower government revenue growth. Recall that the bulk of the cuts in personal and business tax rates occur after x date.
- Government payments, already high as a % of GDP might be pressured to go even higher in the event of slower growth.

While we applaud the government's commitment to cap tax receipts and 23.9% and pass on additional revenues as personal tax cuts, we would note that a receipts cap of 23.9% is still historically high. Indeed tax receipts have rarely been higher (only in 5 occasions in 48 years and four of those were associated with a spike in commodity prices). More normal levels are for tax receipts to be at 21.5% of GDP. Our pre-budget submission called for the government to lower this cap to a still high 23.5%, largely as a first step toward more normal levels.

More generally, much more needs to be done to bring government spending back toward historical norms – especially at a time when ultra-low interest rates and an accelerating global economy are still offering considerable support.

This is not an environment where government spending is required to support growth. Yet the government still forecasts spending to remain high over the next two years (at 25.4% in 2018-19) before falling to 24.7% over the projection period. This is still well above the pre-GFC average of 24%. On an accruals basis spending barely falls below 25% (24.9% by 2021-22).

Our pre-budget submission urged the government to enact:

1. Budget repair that was fair to all Australians.

2. Policies that ensured business are well equipped to invest and employ.
3. Polices that ensured the necessary investment in skills and infrastructure that will promote long-term economic growth and lead to higher standards of living.

On the basis of this budget and notwithstanding some of the positive announcements (taken in isolation), we would have liked to have seen more done to address these three critical issues.

3. Headline announcements

Tax

- **Instant Asset Write-down Extended**

The Government will extend the 2015-16 Budget measure *Growing Jobs and Small Business — expanding accelerated depreciation for small businesses* by a further 12 months to 30 June 2019 for businesses with aggregated annual turnover less than $10 million. This initiative is also known as the $20,000 instant asset write-off.

Small businesses will be able to immediately deduct purchases of eligible assets costing less than $20,000 first used or installed ready for use by 30 June 2019. Only a few assets are not eligible (such as horticultural plants and in-house software).

Assets valued at $20,000 or more (which cannot be immediately deducted) can continue to be placed into the small business simplified depreciation pool (the pool) and depreciated at 15 per cent in the first income year and 30 per cent each income year thereafter. The pool can also be immediately deducted if the balance is less than $20,000 over this period (including existing pools).

The current 'lock out' laws for the simplified depreciation rules (these prevent small businesses from re-entering the simplified depreciation regime for five years if they opt out) will continue to be suspended until 30 June 2019.

The measure will improve cash flow for small businesses, providing a boost to small business activity and investment for another year.

This measure is estimated to have a cost to revenue of $350.0 million over the forward estimates period.

The immediate deductibility threshold and the balance at which the pool can be immediately deducted are normally $1,000.

- **7-Year Personal Income Tax Plan**

This will provide permanent tax relief to low and middle income earners to help with cost of living pressures. The second step will provide relief from bracket creep by increasing the threshold of the 32.5 per cent personal income tax bracket and the third step will simplify and flatten the system by removing the 37 per cent tax personal income tax bracket.

Step 1: Targeted tax relief to low and middle income earners

The Government will introduce the Low and Middle Income Tax Offset, a non-refundable tax offset of up to $530 per annum to Australian resident low and middle income taxpayers. The offset will be available for the 2018-19, 2019-20, 2020-21 and 2021-22 income years and will be received as a lump sum on assessment after an individual lodges their tax return.

The Low and Middle Income Tax Offset will provide a benefit of up to $200 for taxpayers with taxable income of $37,000 or less. Between $37,000 and $48,000, the value of the offset will increase at a rate of three cents per dollar to the maximum benefit of $530. Taxpayers with taxable incomes from $48,000 to $90,000 will be eligible for the maximum benefit of $530. From $90,001 to $125,333, the offset will phase out at a rate of 1.5 cents per dollar. The benefit of the Low and Middle Income Tax Offset is in addition to the existing Low Income Tax Offset.

This first step of the Government's Personal Income Tax Plan will increase disposable incomes to help relieve household budget pressures.

Step 2: Protecting middle income Australians from bracket creep

From 1 July 2018, the Government will increase the top threshold of the 32.5 per cent personal income tax bracket from $87,000 to $90,000.

From 1 July 2022, the Government will increase the Low Income Tax Offset from $445 to $645 and extend the 19 per cent personal income tax bracket from $37,000 to $41,000 to lock in the benefits of Step 1. The increased Low Income Tax Offset will be withdrawn at a rate of 6.5 cents per dollar between incomes of $37,000 and $41,000, and at a rate of 1.5 cents per dollar between incomes of $41,000 and $66,667.

From 1 July 2022, the Government will further increase the top threshold of the 32.5 per cent personal income tax bracket from $90,000 to $120,000.

Together, these tax cuts represent the second step in the Government's Personal Income Tax Plan. The changes will improve the rewards from work and prevent more Australians from moving into higher tax brackets.

Step 3: Ensuring Australians pay less tax by making the system simpler

In the third step of the Personal Income Tax Plan the Government will simplify and flatten the personal tax system by removing the 37 per cent tax bracket entirely.

From 1 July 2024, the Government will extend the top threshold of the 32.5 per cent personal income tax bracket from $120,000 to $200,000, to recognise inflation and wage growth impacts. Taxpayers will pay the top marginal tax rate of 45 per cent from taxable incomes exceeding $200,000 and the 32.5 per cent tax bracket will apply to taxable incomes of $41,001 to $200,000.

This measure has a cost to revenue of $13.4 billion over the forward estimates period.

This measure builds on the 2016-17 Budget measure *Ten Year Enterprise Tax Plan — targeted personal income tax relief*, which extended the 32.5 per cent personal income tax bracket from $80,000 to $87,000 from 1 July 2016.

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Research and Development

The Government will amend the research and development (R&D) tax incentive to better target the program and improve its integrity and fiscal affordability in response to the recommendations of the 2016 *Review of the R&D Tax Incentive*. The changes will apply for income years starting on or after 1 July 2018.

For companies with aggregated annual turnover of $20 million or more, the Government will introduce an R&D premium that ties the rates of the non-refundable R&D tax offset to the incremental intensity of R&D expenditure as a proportion of total expenditure for the year. The marginal R&D premium will be the claimant's company tax rate plus:

- 4 percentage points for R&D expenditure between 0 per cent to 2 per cent R&D intensity;
- 6.5 percentage points for R&D expenditure above 2 per cent to 5 per cent R&D intensity;
- 9 percentage points for R&D expenditure above 5 per cent to 10 per cent R&D intensity; and
- 12.5 percentage points for R&D expenditure above 10 per cent R&D intensity.

The R&D expenditure threshold — the maximum amount of R&D expenditure eligible for concessional R&D tax offsets, will be increased from $100 million to $150 million per annum.

For companies with aggregated annual turnover below $20 million, the refundable R&D offset will be a premium of 13.5 percentage points above a claimant's company tax rate. Cash refunds from the refundable R&D tax offset will be capped at $4 million per annum. R&D tax offsets that cannot be refunded will be carried forward as non-refundable tax offsets to future income years.

Refundable R&D tax offsets from R&D expenditure on clinical trials will not count towards the cap.

The Government will further improve the integrity of the R&D program by implementing stronger compliance and administrative improvements. These improvements include increased resourcing for the Australian Taxation Office and Department of Industry, Innovation and Science, which will be used to undertake greater enforcement activity and provide improved program guidance to participants. Other changes include improving the transparency of the program by enabling the ATO to publicly disclose claimant details and the R&D expenditure they have claimed, limits on time extensions to complete R&D registrations and amendments to technical provisions (such as the feedstock and clawback rules and the general anti-avoidance rules).

The measure is estimated to have a net gain to the budget of $2.4 billion in fiscal balance terms over the forward estimates period. In underlying cash terms, the net gain to the budget is $2.0 billion over the forward estimates period.

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VET/Education/Training/Skills

Higher Education Loan Program — partial cost recovery

The Government will raise $30.7 million over four years from 2018-19 by introducing partial cost recovery arrangements for the *Higher Education Loan Program* (HELP). The arrangements will come into effect from 1 January 2019 and will include an:

- annual charge that is applied to all HECS-HELP and FEE-HELP approved higher education course providers to partially recover the costs associated with administering the HECS-HELP and FEE-HELP programs; and
- application fee that is applied to all higher education course providers seeking approval to offer FEE-HELP loans to recover the costs associated with administering the FEE-HELP application process.

The new arrangements are in accordance with the Australian Government Charging Framework.

Managing the Skilling Australians Fund — revised implementation arrangements

The Government will provide $250.0 million in 2017-18 to fund a range of projects under the *Skilling Australians Fund* (the Fund) which provides support for apprenticeships and traineeships. The projects will support growth in trade and non-trade apprenticeships and traineeships in target areas.

In the absence of levy revenue from the Skilling Australians Fund levy (SAF levy) in 2017-18, the Government has revised the implementation arrangements of the Fund to align to the expected levy arrangements.

State and Territory governments will be offered a new agreement which is estimated to provide $1.2 billion over the four years to 30 June 2022. This is based on current SAF levy revenue estimates plus total additional funding of $50.0 million per year over the four years from 2018-19, on a per capita basis, to provide certainty to the States and Territories and support apprentices and trainees.

The requirement for the States and Territories to meet budget benchmarks and matched funding requirements remains unchanged. The Fund will prioritise apprenticeships and traineeships, including in occupations in high demand, occupations with a reliance on skilled migration pathways, industries and sectors of future growth, trade apprenticeships, and apprenticeships and traineeships in regional and rural areas.

An additional $50.0 million is available in 2017-18, on a per capita basis, to those States and Territories that sign on to participate in the Fund on or before 7 June 2018.

Funding for these elements have already been provisioned by the Government.

This measure builds on the 2017-18 Budget measure titled *Skilling Australians Fund*.

More Choices for a Longer Life — skills checkpoint for older workers program — establishment

The Government will provide $17.4 million over four years from 2018-19 to establish the Skills Checkpoint for Older Workers program, which will support employees aged 45-70 to remain in the workforce.

From 1 September 2018, 5,000 employees each year would be entitled to receive customised career advice on transitioning into new roles, or their pathways to a new career, including referrals to relevant training options.

See also the related expense measure titled *More Choices for a Longer Life — jobs and skills for mature age Australians* in the Jobs and Innovation portfolio.

National Partnership Agreement on Universal Access to Early Childhood Education — extension

The Government will provide $441.6 million over two years from 2018-19 to extend the National Partnership Agreement on Universal Access to Early Childhood Education for the 2019 calendar year and to undertake the related National Early Childhood Education and Care Collection in early 2020. The extension will support 15 hours of preschool each week (600 hours per year) for a further cohort of children in the year before school.

Funding for this measure has already been provided for by the Government.

This measure extends the 2017-18 Budget measure titled *National Partnership Agreement on Universal Access to Early Childhood Education — extension.*

Further information can be found in the press release of 3 February 2018 issued by the Minister for Education and Training.

Tertiary Education Quality and Standards Agency — full cost recovery

The Government will provide additional funding of $24.3 million over four years from 2018-19 to assist the Tertiary Education Quality and Standards Agency (TEQSA) to strengthen the agency's regulatory oversight of the higher education sector, meet the significant increase in applications for registration from prospective providers, and protect Australia's reputation for high quality higher education. This measure will also provide TEQSA with additional resources to crack down on contract cheating, and includes $0.8 million in capital funding in 2018-19 to enhance TEQSA's IT systems.

From 1 January 2019, a new levy on higher education providers will be introduced, to be phased in over three years, to recover the costs of TEQSA's risk monitoring and oversight activities that benefit the higher education sector as a whole. TEQSA will transition to full cost recovery from 2021-22, generating additional revenue of $28.3 million, resulting in a net saving to the Budget of $4.0 million over four years from 2018-19. The policy will be implemented in accordance with the principles of the Australian Government Charging Framework.

Trades Recognition Australia — additional funding

The Government will provide an additional $1.2 million in 2018-19 to upgrade Trades Recognition Australia's existing IT systems to better support its ongoing role in managing technical and trade skills assessments sought by potential migrants to Australia, including charging arrangements.

Unique Student Identifier Initiative — additional funding

The Government will provide an additional $16.5 million over four years from 2018-19 to address ongoing resourcing needs of the Unique Student Identifier (USI) transcript service, including to allow VET students to grant transcript access to authorised employers and licensing bodies.

The USI transcript service provides VET students with a secure online record of their nationally recognised training and qualifications gained in Australia.

The cost of this measure will be met from within the existing resources of the *National Training System — Commonwealth Own Purpose Expenses* program, consistent with previous funding arrangements agreed with State and Territory governments.

VET Student Loans Ombudsman — additional resources

The Government will provide an additional $1.0 million in 2018-19 to the Office of the Commonwealth Ombudsman to support the increased workload of the VET Student Loans Ombudsman associated with managing and investigating student complaints.

This measure builds on the 2016-17 MYEFO measure titled *VET Student Loans — establishment*.

4. Economic Outlook

Changes in the economic outlook can have a significant impact on the budget estimates. For instance, changes to parameter estimates (which include changes to the economic and wage growth etc forecasts) add $31.5 billion to the governments receipts in the four years to 2021-22, compared to the Mid-year outlook in December.

Within that, global growth is expected to remain little changed over the next few years, although the government made a modest upgrade to global growth in 2018 (3 ¾% from 3 ½%). Beyond that, forecasts for global growth look similar to what what's expected in the Mid-Year Economic and Fiscal Outlook released in December (3 ¾%). This would appear quite reasonable and not inconsistent (broadly speaking) with forecasts from the IMF.

On the domestic side, growth expectations have been revised up somewhat in 2017-18 to 2 ¾% from 2 ½%. Real GDP was forecast at 3% over the projection period and this is little changed from the Mid-Year Economic and Fiscal Outlook (MYEFO) released in December 2017.

The unemployment rate is expected to fall from 5 ½% in 2017-18, to 5% in 2021-22. Otherwise, CPI inflation is expected to rise from 2% in 2017-18, to 2 ½% in in 2021-22.