Federal Budget 2016

A review of the Budget's major business implications

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Executive summary

Gary Wingrove
Chief Executive Officer

An economic plan

The government is seeking to elevate this year's Budget to a long term "economic plan" that will support Australia's transition into an advanced and diverse economy. The path towards fiscal sustainability, however, is proving difficult, with the government still forecasting deficits up to 2019 – 20.

Key decisions in the Budget include:

- Expenditure reductions: in education and training, health and social services as well as a public sector efficiency dividend.
- Retirement income: superannuation concessions are pared back for higher income earners, with improved access to superannuation for those on lower incomes. The tax policy focus now shifts to the pension phase of superannuation where benefits are now being capped.
- Personal taxes: changes to the marginal tax rate threshold for individuals earning greater than $80,000, with negative gearing being retained.
- Business taxes: a staged reduction in corporate income tax rates and the expansion of smaller business tax benefits, which will be funded by new tax integrity measures focused on multinational businesses.

The reduction in the corporate tax rate is to be introduced over an 11 year transition period. While we welcome the reduction in the rate, the timetable is drawn out.

There are two major challenges that have not been addressed. Firstly, we need to keep tax reform on the agenda. While the measures on superannuation and company taxation are consistent with a broad reform agenda, Australia needs to undertake more fundamental change.

Secondly, the funding of the States and Territories in respect of Health and Education over the long term remains outstanding, following the decision in the 2014 Budget to limit increases to CPI from 2020. This issue goes to the heart of our federation.

What does this mean for business?

Business will benefit in the long term by lower company tax rates, although access to the reduced rates will not flow through to our larger companies for many years. Multinational businesses will also need to deal with the additional scrutiny from the Australian Taxation Office that will no doubt arise as part of the government's agenda to combat profit shifting.

Transparency reporting in all its guises is here to stay. How a business proposes to respond requires careful consideration.

Gary Wingrove

Chief Executive Officer

Economic and fiscal analysis

Australia is continuing to experience below trend economic growth, albeit we are still performing notably better than many other developed countries.

Our resources ‘boom’ has now shifted into ‘production mode’, with export volumes growing substantially year-on-year. While world prices for many of our resource exports has fallen dramatically from their peaks, the volume effect is taking over and net exports are still strongly contributing to Australia’s economic growth story. Domestic consumption’s contribution to economic growth has been relatively constant for the past 2 years, averaging around 0.35 percent per quarter.

KPMG’s latest macroeconomic forecasts show the economy gradually improving over the forward estimates period, reaching trend growth back around FY19 and FY20. Business investment remains subdued, even with tonight’s Budget gradually reducing the corporate income tax rate. Inflation is expected to remain under control throughout the forecast period, staying with the RBA target band of 2 percent to 3 percent. Consequently, interest rates are likely to remain accommodating, helping further stimulate investment activity, reducing unemployment in the process.

Our analysis of the Budget Statement suggests that the Underlying Cash Balance will be worse than Treasury estimates, although it is the out years where the differences are most pronounced. Treasury is expecting tax revenue to be more responsive to GDP growth between FY18 and FY20 than has historically been the case, on average, than the past 15 years.

Further, taking into consideration the structural elements of the Budget, our medium term forecasts show – in the absence of any meaningful reforms to either government receipts or expenditures – Australia’s Structural Budget Balance remains in a deficit position of between 2.5 percent and 3 percent of nominal GDP out to 2030.

Key insights

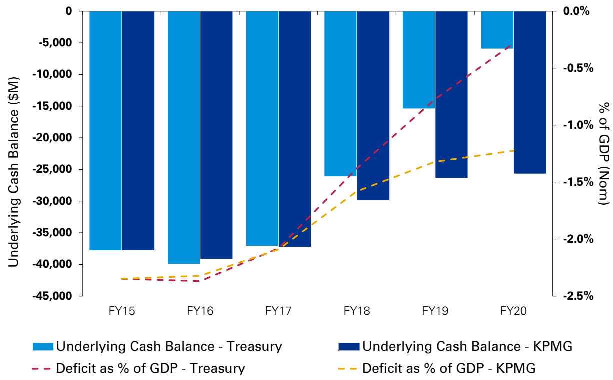
- Softer economic conditions, particularly due to declining business investment in the mining sector, warrant the running of budget deficits in the forward estimate period.
- KPMG broadly concurs with Treasury economic forecasts, although we are less optimistic that tax receipts will be as strong as anticipated, particularly taxation revenue generated from individuals and companies.

Brendan Rynne

Partner, Chief Economist

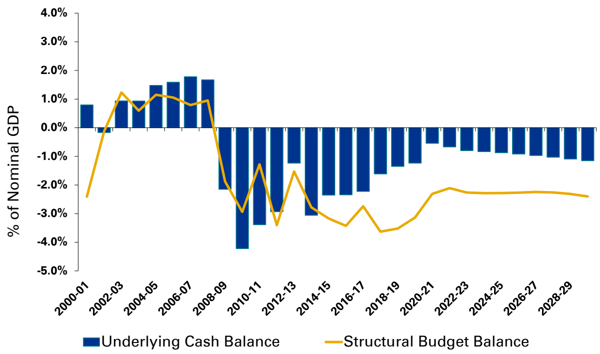
“Australia’s economy is expected to only achieve sanguine growth over the next few years, even despite the stimulatory fiscal policy settings in tonight’s Budget.”

Commonwealth Budget Underlying Cash Balance



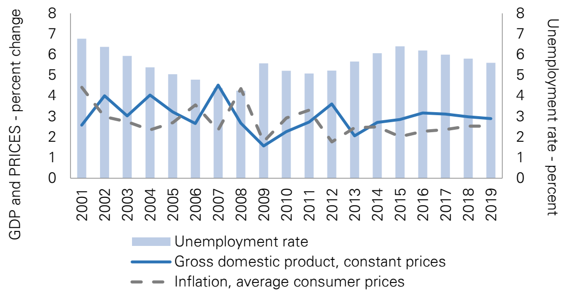
Source: Commonwealth Treasury, KPMG Economics

Structural budget balance estimates



Source: KPMG Economics, Treasury

A sound macro economy



Source: Federal Budget papers and IMF publications

Economic assumptions

When interpreting the Budget estimates, the likelihood of volatility in economic fundamentals is an important consideration. Key risks for macro indicators are presented below.

Real GDP growth – continuing trend growth

	2015	2016	2017	2018	2019
GDP (Real)	2.5%	2.5%	3.0%	3.0%	2.9%

The resource sector continues to transit from an investment phase to a production phase, with iron ore exports growing faster. Higher resource exports will make the economy more sensitive to terms of trade shocks, and the floating exchange rate will be an important buffer.

Growth in real GDP	2016
United States	2.4%
Canada	1.5%
United Kingdom	1.9%
Japan	0.5%
China	6.5%

Unemployment rate – recovering very slowly

	2015	2016	2017	2018	2019
Unemployment	6.1%	5.9%	5.8%	5.7%	5.7%

Spare capacity in the economy has continued to increase, with the unemployment rate rising above NAIRU, consistent with the below trend economic growth. Labour market conditions are expected to recover very gradually, with the unemployment rate declining once economic growth improves.

Unemployment rate	2016
United States	4.9%
Canada	7.3%
United Kingdom	5.0%
Japan	3.3%
China	4.1%

Consumer price index – within band

	2015	2016	2017	2018	2019
CPI	1.5%	2.1%	2.4%	2.5%	2.5%

Inflation is expected to come in below the target band, reflecting the fall in oil prices and weaker performance for the economy and labour market. Expectations of a depreciating Australian dollar are expected to pose upward pressure on inflation over the projection period.

CPI	2016
United States	0.8%
Canada	1.3%
United Kingdom	0.8%
Japan	-0.2%
China	1.8%

Public net debt as a percentage of GDP

	2015	2016	2017	2018	2019
Public net debt	17.9%	19.5%	19.9%	19.2%	18.2%

Net government debt as a percentage of GDP – a key measure of fiscal sustainability – remains low by international standards, and is expected to remain less than 20 percent into the medium term.

Debt as a percentage of GDP	2016
United States	82.2%
Canada	27.5%
United Kingdom	80.6%
Japan	129.6%
China	n/a

Source: IMF

Personal tax

Income Tax

Bracket creep is where average rates of income tax increase as a result of inflation under a progressive personal tax system. As wages rise but bracket thresholds remain static, the absolute burden of taxation on an individual increases, adding further strain to the relationship between effort and reward.

This Budget has sought to address this by increasing the income threshold at which the 37 percent tax rate commences from $80,000 to $87,000 from 1 July 2016. This will provide a small tax cut to middle income earners, but falls short of providing the cuts to taxpayers across the board that full indexation of tax brackets would have achieved.

Despite this measure, across OECD countries, Australia will still have one of the highest income tax rates for a single person earning the average national wage, at 22.7 percent (trailing only Denmark at 35.8 percent and Iceland at 26.7 percent). By comparison, rates in New Zealand, the US and the UK are much lower, at 17.6 percent, 16.5 percent and 12.8 percent respectively.

No announcement has been made either to extend the Temporary Budget Repair Levy, or to repeal it early, and it therefore remains set to expire at the end of the 2016 – 17 income year.

There have been no changes proposed in connection with work-related expenses.

Andy Hutt

National Leader,
Global Mobility Services

"Attempts to address bracket creep are welcome, but the measures announced fall short of solving the problem. They're funded by the additional tax burden introduced on superannuation contributions."

Tax savings

The combination of these announcements have the following impact on a resident individual with taxable income of $190,000:

	FY16 $	FY17 $	FY18 $
Gross salary	190,000	190,000	190,000
Income tax & Medicare Levy	(62,847)	(62,532)	(62,532)
Budget repair levy	(200)	(200)	0
Total tax	**(63,047)**	**(62,732)**	**(62,532)**
Net income	**126,953**	**127,268**	**127,468**

Other measures

Consistent with announcements leading into the Budget, there have been no changes made to negative gearing or the taxation of discount capital gains.

From 1 July 2017, taxpayers with an adjusted taxable income exceeding $250,000 will pay tax on concessional superannuation contributions at 30 percent. Currently, only taxpayers with an adjusted taxable income exceeding $300,000 pay 30 percent tax on contributions.

Concessional contributions will be capped at $25,000 from 1 July 2017.

Key insights

- Economic expansion and bracket creep have served to reduce Australia's budget deficit. This Budget seeks to return a small part of the tax revenue resulting from bracket creep back to individual taxpayers by increasing the threshold at which the 37 percent tax rate commences to $87,000. The changes fall short of fully addressing bracket creep by, for example, full indexation of tax bracket thresholds and lower income taxpayers will not benefit from this change.

Business tax

Top 5 changes

1

Reduction in corporate tax rate

The government will reduce the corporate tax rate, ultimately to 25 percent, on an 11 year phased basis depending on turnover, commencing 1 July 2016.

	Turnover	Rate
2016-17	<$10m	27.5%
2017-18	<$25m	27.5%
2018-19	<$50m	27.5%
2019-20	<$100m	27.5%
2020-21	<$250m	27.5%
2021-22	<$500m	27.5%
2022-23	<$1b	27.5%
2023-24	All	27.5%
2024-25	All	27%
2025-26	All	26%
2026-27	All	25%

This reduction is expected to increase GDP by 1 percent over the long term.

Franking impacts will be important, as taxpayers will only be able to frank at the reduced rate of tax paid to the company. This will impact financial statement tax disclosures once substantively enacted.

2

Collective investment vehicle (CIV) changes

Aligned with Australia's participation in the Asia Region Funds Passport, from 1 July 2017, Australia will introduce new CIVs that are more attractive to foreign investors and will enhance Australia's ability to attract foreign capital, particularly in infrastructure.

Initially, this will comprise a corporate CIV, followed by a limited partnership CIV from 1 July 2018. Both vehicles, will be more attractive to investors from non-common law countries that do not have experience with investing through trusts. Further consultation, including on withholding tax rates, will be undertaken by Treasury.

3

Tax Integrity Package

The government has announced significant measures on anti-avoidance, including:

- A new diverted profits tax (discussed in the International Tax section).

David Linke

National Managing Partner, Tax

"This budget presents a substantial investment by the ATO in compliance activities for multinationals and high network individuals. New anti-avoidance rules give the ATO substantial additional power."

- Anti-hybrid rules to commence from the later of 1 January 2018 or 6 months after enabling legislation receives Royal Assent. These are designed to prevent double taxation benefits on cross-border transactions.
- Additional funding of $679 million to the ATO to establish a new Tax Avoidance Taskforce. This is expected to raise additional revenue of $3.7 billion.
- Finally, whistleblower legislation for taxation matters to apply from 1 July 2018.

4

Disclosure and transparency measures

Treasury will consult on introducing Mandatory Disclosure Rules, primarily applying to tax advisers, regarding tax arrangements that meet the ATO's (pre-determined) parameters as "aggressive".

The government has also announced the implementation of a voluntary Tax Transparency Code based on the recommendations of the Board of Taxation. The code will require, amongst other things a reconciliation of tax payable with accounting paid. The government is encouraging companies to adopt the Code from the 2016 financial year onwards with revenue in excess of $100 million.

5

Penalties for non-compliance

Penalties for non-compliance with lodgement obligations for companies with global revenue in excess of $1 billion will increase 100-fold from 1 July 2017, with the maximum penalty for non-compliance increased from $4,500 to $450,000. Combined with the 2015 ATO tax governance guidelines, taxpayers will need to focus on tax risk management controls.

Business tax

Next 8 changes

1

Tax consolidation - deductible liabilities

Where a tax consolidation calculation is undertaken on the purchase of a company, liabilities which will be deductible to the purchaser in future years, such as employee annual leave, will remain deductible but will not contribute to the tax cost setting process. This differs (and is simpler) from the previous proposal in the 2013 – 14 Budget. The date of effect is 1 July 2016 (rather than the previous start date of 14 May 2013).

There are two other technical announcements covering deferred tax liabilities, which will be excluded from consolidation calculations for transactions occurring after the legislative bill is introduced and broadening recent securitisation amendments to non-financial institutions.

2

OECD Guidelines on transfer pricing

The government will introduce regulations for Australia to adopt the new OECD Guidelines for transfer pricing from 1 July 2016.

3

Taxation of Financial Arrangements to be simplified

These welcome measures, designed to simplify the TOFA regime for income years starting on or after 1 January 2018, has 4 key components: (1) a closer link to accounting; (2) simplified accruals and realisation rules; (3) a new tax hedging regime, including removing the link to accounting; and (4) simplified rules for forex gains and losses.

4

FIRB tax conditions

The Treasurer released revised Tax Conditions applying to foreign investment applications. KPMG welcomes these changes, which address a number of concerns identified during consultation with key stakeholders. They provide additional clarity on how these conditions should apply, with further detail expected in Guidance Notes to be released by FIRB. With the increased importance of tax related matters to FIRB's considerations, it is important that the ATO is not undertaking an up-front audit of all transactions prior to FIRB approval.

5

Asset backed financing

Laws will be introduced so that the taxation outcomes for asset backed financing, also known as Islamic financing, will be the same as for traditional financing arrangements. These rules are to be introduced to apply from 1 July 2018.

6

GST on low value imported goods

The GST will be extended to low value imported goods. Overseas suppliers that have a turnover in Australia of more than $75,000 will be required to register for, collect and remit GST, using a vendor registration model. These rules are to apply from 1 July 2017.

7

Wine Equalisation Tax rebate

Currently a rebate of up to $500,000 per year is available to Australian wine producers to reduce or eliminate their WET liabilities. This will be reduced to $350,000 on 1 July 2017 and to $290,000 on 1 July 2018. Additional eligibility requirements will also be introduced.

8

Excise on Tobacco will increase by 12.5 percent

Tobacco excise will increase by 12.5 percent annually from 1 July 2016. This will raise an additional $4.7 billion net revenue over 4 years.

International tax

Diverted profits tax

The government will introduce a new diverted profits tax (DPT) with effect for income years beginning on or after 1 July 2017.

The DPT is modelled on the second limb of the UK's DPT, the first limb of which was adopted in the 2015 Budget as the multinational anti-avoidance law (MAAL). This provision is aimed at arrangements involving transactions with overseas related parties which are subject to a tax rate which is less than 80 percent of the tax rate applied in Australia, where the arrangement lacks economic substance.

Essentially, the objective of this measure is to change the balance of negotiation with large business on transfer pricing and structuring issues.

The DPT will impose a penalty tax rate of 40 percent, and any purported underpayment of tax determined by the ATO is payable upfront. In addition, the DPT assessment will include an interest charge for the period from when any amount would have been payable on the relevant income tax assessment, to the issue of the ATO's DPT assessment.

Key requirements for DPT to apply

The main conditions that need to be satisfied for the DPT to apply are:

Size. The DPT will apply only to Australian resident entities or Australian permanent establishments of foreign entities which are members of a multinational group that has an annual income of $1 billion or more (the same threshold currently applicable for the MAAL).

However, to ensure the DPT does not adversely affect low-risk taxpayers, the DPT will not apply if the Australian resident entity itself has turnover of less than $25 million (subject to limited exceptions).

Peter Madden

National Leader, International Tax

"This is a new weapon designed to change the balance of the negotiating power between the Commissioner and large multinationals. Aggressive tactics in dealing with the ATO will become a very unattractive path in the future."

Similar taxed countries. If the income that is not taxed in Australia under the arrangement is taxed at a rate less than 80 percent of the Australian tax rate, then the rules apply. This has been a difficult test under the UK rules and care will need to be made with the drafting to avoid a similar problem.

Economic substance test. The rules apply where there is insufficient economic substance.

Determination of whether there is insufficient economic substance will be based on whether it is reasonable to conclude, based on information available to the ATO, that the arrangements were "designed to secure" a tax reduction. Sufficient economic substance will exist if the non-tax financial benefits are greater than the tax benefits. This is a new test in our anti-avoidance provisions and represents a significant tightening of the threshold at which anti-avoidance provisions apply.

Application. If the rules apply, the ATO will issue a provisional DPT assessment and taxpayers will have 60 days to respond to factual matters set out in the provisional assessment. If the ATO subsequently issues a final DPT assessment, taxpayers will have 21 days to pay the purported underpayment of tax.

Date of application. The new arrangements apply for income years commencing on or after 1 July 2017. There is no grandfathering of existing arrangements.

Key insights

- The second "MAAL" is seen to fill a gap in the negotiating power of multinationals in dealing with the ATO. Disputed tax will be paid upfront and the threshold test to be applied will be based on information made available to the ATO. The future is very much one of opening a dialogue with the ATO.
- Our transfer pricing rules have a reconstruction power where the Commissioner can substitute new structures where an existing one is not perceived to be arm's length. The UK does not have such a power in their transfer pricing rules. In Australia, with the general rule in Part IVA and the reconstruction power in transfer pricing, we will have three levels to consider with the addition of this new MAAL on international structures.

Small business

Reduction in corporate tax rate

For small business companies with turnover of less than $10 million, the company tax rate will be reduced to 27.5 percent from 1 July 2016. Currently a tax rate of 28.5 percent applies to small business companies with turnover of less than $2 million.

For companies with turnover of more than $10 million there will be the broader phased reduction in the corporate tax rate to 27.5 percent for the 2022 – 23 income year reducing to 25 percent from the 2026 – 27 income year.

Extension of small business tax measures

From 1 July 2016 there is to be an extension of a variety of concessional tax measures currently available to small business entities with a turnover of up to $2 million to entities with a turnover of less than $10 million. Such measures include:

- an immediate write-off for each asset costing less than $20,000 until 30 June 2017, and then less than $1,000
- simplified trading stock rules if the value of stock has changed by less than $5,000
- simplified method for calculating PAYG instalment payments
- the option to account for GST on a cash basis and pay GST instalments as calculated by the ATO.

Unincorporated businesses

The tax discount for unincorporated small businesses with turnover of less than $5 million will increase over a 10 year period from 5 percent to 16 percent. The tax discount will increase to 8 percent on 1 July 2016. However, the maximum discount will remain capped at $1,000.

Simon Thorp

Partner, Enterprise

"There is a welcome recognition in many of the changes announced that existing tax laws are stifling small and medium businesses and diverting key contributors to the economy from maximising the potential of such businesses."

Modification of rules to private company loans

Australia has very complex rules that apply where a private company makes loans, payments or forgives debts in respect of a shareholder or an associate. In certain circumstances such transactions are treated as an assessable and unfranked dividend.

The government will consult with stakeholders to make targeted amendments to these rules to improve their operation and administration. Potential amendments include:

- new safe harbour rules, including in respect of the use of assets, to provide certainty of the application of Division 7A and simplify compliance
- a self-correction mechanism to allow voluntary correction of arrangements, without penalty, which have inadvertently triggered Division 7A
- changes to complying Division 7A loans including having a single compliant loan duration of 10 years and a better aligning calculation of the minimum interest rate with commercial transactions.

It is proposed that the amendments will apply from 1 July 2018.

Key insights

- Impacted businesses should revisit capital expenditure plans for assets costing less than $20,000.
- Cashflow projections should be re-examined in respect of asset depreciation profiles and company tax rate changes.
- Revisit private company loans and other arrangements.

Superannuation

Objectives of superannuation

	Pre-Budget	Post-Budget
Legislating an objective of superannuation	FSI recommended legislating the objective of superannuation	Objective of superannuation to be legislated
Definition of objective	FSI recommended objective of "to provide for income in retirement to substitute or supplement the Age Pension"	Objective is "to provide income in retirement to substitute or supplement the Age Pension"

There are two welcome initiatives here – firstly, defining an objective for superannuation, and secondly, how that objective has been applied.

Defining the objective is an important step in providing a framework within which superannuation tax policy may be meaningfully assessed.

Having defined the objective in this manner, many of the previous policy settings, that were more consistent with a policy setting of wealth accumulation or estate planning in a concessionally taxed environment have been addressed in the Budget.

Concessional contributions

Concessional Contributions	Pre-Budget	Post-Budget
Tax Rate	Taxed in fund at 15%	No changes
Division 293 15% additional tax	Threshold starts at $300,000	Threshold reduced to start at $250,000
Low income tax contribution	Current, but legislated to expire on 30 June 2017	New Low Income Superannuation Tax Offset up to $500 from 1 July 2017
Annual contribution cap limits	Under 50 - $30,000 50+ - $35,000	Reduced to $25,000
Catch up - Concessional contributions	No	Yes, with 5 year rolling unused amounts carried forward for balances under $500,000
Tax deductions for personal super contributions	Restricted to substantially self-employed	All individuals up to age 75 allowed to contribute up to cap
Work test to make contributions	10 hour work test age 65 – 74	Abolished

Dana Fleming
National Leader, Superannuation Tax

"Having defined the objectives of superannuation as to provide for income in retirement to substitute or supplement the age pension, many of the current tax policy settings that allowed some members to build up excessive concessionally taxed balances, were no longer justifiable. The measures announced in this Budget pass the test in terms of equity, fairness and sustainability."

Reduction of threshold for additional 15 percent tax

Prior to these changes, taxpayers in the $180,000 to $300,000 tax bracket enjoyed the most generous tax concession on concessional contributions – being the difference between the top rate of tax and 15 percent.

Reducing the Division 293 threshold such that it applies to those with adjusted taxable income above $250,000, improves the sustainability and fairness of the system.

Low Income Superannuation Tax Offset (LISTO)

Absent a low income tax offset, low income earners would pay more tax in superannuation than they would if they earnt the income directly.

Introducing the LISTO is an important step in retaining the equity of the tax concessions for low income earners.

Annual concessional contribution caps have been maintained with reduced limits

The reduction in the annual concessional cap to $25,000 is consistent with the newly defined objective. This level of concessional contribution still allows a member to accumulate a sufficient balance in retirement.

New 5 year rolling catch-up

The introduction of a 5 year rolling catch-up for members with balances less than $500,000, is a well-targeted initiative that will improve the superannuation outcomes for those who have variable work patterns, particularly women and carers.

Non-concessional contributions

Non-Concessional Contributions	Pre-Budget	Post-Budget
Annual non-concessional contribution cap limits	$180,000 per year 3 year bring forward rule - $540,000	Lifetime cap of $500,000

Non-concessional contribution caps – new lifetime cap

The ability of some members to make significant non-concessional contributions each year, was one mechanism that allowed members to build up excessive balances in their superannuation fund that was inconsistent with the now-defined purpose of superannuation.

A lifetime non-concessional cap of $500,000 is more consistent with the newly defined purpose.

Taxation of earnings

	Pre-Budget	Post-Budget
Taxation of income in accumulation phase	Taxed at 15%	No change
Taxation of income in pension phase	Taxed at 0%	No change
Maximum balance on transition to pension phase	None	$1,600,000

New limit on fund balance on commencement of pension phase - $1,600,000

Whilst the Henry Review recommended reducing the rate of tax in accumulation phase and introducing that same rate of tax in pension phase, no change was expected in this Budget.

Instead, the government limited the concession in relation to the zero rate on earnings in pension phase, by limiting the balance that could be transferred into pension phase to $1,600,000.

Whilst the size of the cap was unexpected, the capping of balances allowed in pension phase is welcomed and consistent with the now defined policy. This is another example of the better targeting of superannuation tax concessions.

Amounts in excess of $1,600,000 will remain in the accumulation phase account (subject to the 15 percent rate of tax).

Taxation of benefits

	Pre-Budget	Post-Budget
Preservation age	55 increasing to 60 depending on year of birth	No change
Transition to retirement	Available	Changes to improve integrity of provisions
Taxation of tax-free components	Tax free	No change
Taxation of taxable components – elements taxed in the fund	No further tax if over 60	No change
Anti-detriment deduction	Available	Abolished from 1 July 2017

Transition to retirement

The transition to retirement provisions, whilst well intentioned in principle, by assisting Australians to gradually move from full time work to retirement, were open to abuse.

These provisions have been amended to improve their integrity.

Anti-detriment deduction

The anti-detriment provision was outdated and its removal was expected.

Retirement Products

Deferred annuities

The extension of the tax exemption on earnings in the retirement phase to deferred lifetime annuities and group self-annuitisation products is particularly welcome in an environment where superannuation funds are seeking to develop appropriate products and solutions for retiring members.

This initiative will foster the development of better retirement products by both superannuation funds and life insurance companies.

It is also an important step in addressing longevity risks to future budgets.

Key insights

- Definition of the objective of superannuation should improve the confidence in and stability of the system.
- Better targeting of tax concessions will improve the sustainability and equity in the system.
- Measures in relation to retirement products will assist in appropriately addressing longevity risk.

Infrastructure

Overview

While not the cornerstone feature of the Budget, Infrastructure does receive commitments to more than $33 billion over the 4 year forward estimates for new projects.

Key announcements

The government reconfirms a commitment to funding rail infrastructure including more than $3.4 billion in urban rail projects across the country and an additional $594 million in equity over 3 years from 2017 – 18 for the Australian Rail Track Corporation to support the Melbourne to Brisbane Inland Rail Project.

The establishment of a $2 billion Water Infrastructure Loan Facility (for a 10 year period from 1 July 2016) which is proposed to act as a catalyst for new investment in dams and pipelines across Australia with loans to be provided to the States and Territories.

The Western Sydney Airport Project also receives further funding with approximately $115 million over 2 years from 2016 – 17 to fund preparation work, to develop a concept design for rail access and to undertake critical preparatory activities for the airport site.

Review

One of the key aspects of this year's Budget is the demise of the Asset Recycling Initiative (ARI). The ARI scheme, which has been operational since May 2014, will close in 30 June 2016. The scheme will have provided a notional $3.3 billion in funding for new projects from 2014 to 2018 and is credited for unlocking $23 billion in new State and Territory infrastructure spending. A number of key projects, including Sydney Metro and Melbourne Metro, will attract funding from the ARI. With the ARI ending, there is no clear replacement that can unlock funding for infrastructure at a similar scale in the near future.

Over the course of this Budget, the establishment of the $2 billion Water Infrastructure Loan Facility and the previous year's $5 billion concessional loan facility for the development of Northern Australia provide clues as to the government's approach to plugging the gap left by the ARI. Infrastructure loan facilities and concessional loans are becoming a regular feature.

Paul Foxlee
National Sector Leader, Transport & Infrastructure

"The ongoing use of concessional loans signals the government's appetite to explore new methods for funding infrastructure, especially transport and economic infrastructure projects of national significance."

Further out, the future drivers of infrastructure investment may develop out of the Smart Cities Plan, released last week by the government. Under this plan, future investment looks set to come from new arrangements between local, state, territory and Australian Government coming under the City Deal banner, wider implementation of Value Capture, and through greater emphasis on technology that could improve the efficiency and productivity of existing assets.

The following table provides a summary of some of the key project announcements in this Budget:

Announced infrastructure project funding	
Project	**Value $b**
New South Wales	**14.3**
Pacific Highway	5.6
Western Sydney Infrastructure Plan	2.7
Sydney Metro	1.7
Victoria	**2.6**
Melbourne Metro	0.9
Queensland	**10.7**
Bruce Highway	6.7
Toowoomba Second Range Crossing	1.1
Western Australia	**3.3**
Perth Freight Link	1.2
South Australia	**1.9**
Northern Connector	0.8
Other jurisdictions	**1.0**

Key insights

- The ongoing use of infrastructure funding facilities like the $2 billion Water Infrastructure Loan Facility and last year's $5 billion Northern Australia Infrastructure Facility highlights the growing trend in the Commonwealth's use of concessional loans.
- Against this backdrop, the approaches outlined in the Smart Cities Plan, which are focused on incentive-based funding structures such as City Deals and on technology, are good news and look set to drive investment in the future.

Free Trade & Customs

Over the last year the government's free trade agenda has continued with the recent Japan, Korea and China Agreements entering into force and the Trans-Pacific Partnership Agreement (TPP) formally signed on 4 February 2016. Once domestically ratified by its member countries, the TPP will be the world's most extensive free-trade agreement, with the elimination of 98 per cent of customs tariffs amongst its member countries, which represent around 40 per cent of global gross domestic production.

While the TPP measures are expected to cost nearly $200 million over 4 years, the benefits should be realised in the longer term.

Leonie Ferretter

Director, Trade, Customs & Excise

"The importing community and consumers should win overall with the tariff reductions and duty deferral. As Australian exporters have a very low take up of free trade agreements, hopefully the additional funding to educate and support them translates into export growth for Australia."

The government will also provide $69.9 million over 4 years from 2016-17 to implement the *Australian Trusted Trader Programme* which will provide customs duty deferral to accredited importers and Mutual Recognition Arrangements for facilitation of goods for accredited exporters.

The government also announced the closure of the Enhanced Project By-law Scheme (major project duty concession scheme) from 3 May 2016 estimated to result in a revenue gain of $220 million.

Health and ageing

As evidenced by the various reviews in recent years, government is rethinking the way it funds and regulates its significant health and ageing programs. The Budget offers little investment in innovative approaches to a healthier community. Instead it focuses on measures that reduce the annual rate of growth of health expenditure.

Trial of Health Care Homes

As expected, the Budget included an investment in more integrated care for patients suffering from multiple chronic diseases totalling $21 million through Health Care Homes. Given the cost of chronic disease is 30 percent of health expenditure, this funding is relatively small, and unlikely at this scale to make a significant change in spending on chronic disease. It is, however, a good start.

Savings from Medicare Benefits

The Abbott Government announced a review of the Medical Benefits Schedule (MBS). The taskforce is due to report to government in December 2016. In the meantime, this Budget presages some of the likely changes by forecasting savings over the next 4 years, including $66.2 million through reduction in Medicare rorting, $5.1 million by removing obsolete items, $51.4 million through amendments to some skin and varicose vein treatment items, and most importantly, savings of $925.3 million by extending the pause on indexation of the scheduled fees. The review of the MBS and other reviews continue to be key in the government's stated plan to return to a balanced position.

Increased hospital funding

The government's announcement at the 1 April 2016 COAG meeting of an additional $2.9 billion funding to the States for hospitals goes some way toward closing the gap created by the funding reduction in the last Abbott Budget.

Private Health Insurance unchanged

Government support for private health insurance is structurally unchanged by the budget. Already announced measures associated with pausing indexation on income thresholds for the Medicare Levy Surcharge and Private Health Insurance rebates will be extended from 1 July 2018, producing $744 million in efficiencies over 3 years.

Liz Forsyth

National Sector Lead, Health, Ageing and Human Services

"Implementing the Aged Care reform agenda is a significant challenge which must ensure fair outcomes for providers, and the protection of service availability and affordability, particularly for those in rural and regional areas and those with special needs."

Rural health

Rural communities saw modest focus through higher MBS rebates for rural and remote registrars, and the listing of a new item for retinal photography on the MBS that will improve access to ophthalmic and optometric services for detection of diabetic retinopathy.

Aged care

The 2015 Department of Health review identified significant challenges relating to sustainability for providers in rural and remote areas. This Budget has announced $102.3 million funding support over 4 years from 2016 – 17 for rural and remote aged care providers. This will enable providers to be viable, and continue to offer residential services to older Australians living in rural and remote Australia.

Key insights

- The health Budget reflects a government focused on living within its means and returning to a balanced position.
- The small number of programs that demonstrate innovative approaches to transforming care, such as Health Care Homes, have received limited funding for pilots that will not translate into system change in the near term.
- Changes to the Aged Care Funding Instrument and reduction in indexation will achieve savings, whilst reducing care and support available to older Australians.

Human services

Human Services is a broad topic and large area of government spending covering:

- Welfare Reform
- Youth Employment
- National Disability Insurance Scheme.

Welfare Reform

The McClure Inquiry into Welfare Reform identified 20 income support payments and 55 supplementary payments creating complexity and a lack of clarity regarding incentives to work. While some measures seek to align rules across payment types, more significant reform to the payment system has not been proposed in a pre-election environment.

Building on the New Zealand Investment Approach, the government has announced a modest trial titled the Try Test and Learn Fund ($96.1 million over 4 years from 2016 – 17). The approach seeks to trial interventions to identify individuals and families at risk of long term welfare dependence, using actuarial analysis to assess the impact of those interventions.

Newstart

It is commonly recognised that Newstart payments are inadequate, and significantly so. The Business Council of Australia (BCA 2014) has pointed out that the low level of Newstart is actually forming a barrier to employment: it is difficult for unemployed people to get work ready. Disappointingly, the government has not made changes to the Newstart base rate, a matter which remains to be corrected.

Youth Employment

The Budget announced significant new measures to improve youth employment outcomes, principally through expansion of the New Enterprise Incentive Scheme by expanding eligibility criteria ($88.6 million over 4 years from 2016 – 17) and a suite of innovative new measures to reduce youth unemployment.

National Disability Insurance Scheme

Investment by the Government in the implementation of the National Disability Insurance Scheme (NDIS) through support for existing trials and transitions to the full Scheme with the States and Territories continues. Once fully implemented, the NDIS will provide reasonable and necessary care and support tailored to individual circumstances for over 460,000 eligible people with a significant and permanent disability.

The Budget confirms the creation of a Special Account to provide for the future costs of the NDIS – with a contribution of $2.1 billion in 2016 – 17. This special account is funded in large part through a series of savings measures within the DSS portfolio, primarily:

- $1.4 billion in the cessation of carbon tax compensation measures for new income support applicants
- $108.6 million through aligning backdating provisions for Carer Allowance
- $62.1 million through reviews of the work capacity of Disability Support Pension recipients.

Violence Against Women & Children

Domestic and family violence has received significant and warranted attention in recent times. The Budget provides for an additional $100 million over 3 years from 2016 – 17 toward Commonwealth initiatives to break the cycle of violence against women and children drawing on the recommendations of the Third Action Plan 2016 – 19 (the Plan) under the National Plan to Reduce Violence Against Women and their Children 2010 – 22.

Key insights

- The Budget has not taken the opportunity to commence a necessary and more fundamental reform of welfare payment arrangements.
- There has been a welcome and necessary investment in Commonwealth responses to Violence Against Women and Children.
- The Prime Minister's Closing the Gap report has confirmed that Australia is failing to address indigenous disadvantage (other than for under-five-year-olds). There has been no reduction in the longevity gap since 2009. A significant opportunity exists to provide new investment in this area to affect impactful change.

Education

Education is a key lever for Australia to unlock the productivity of the next generation. Federal Government investment and policy settings are critical in supporting our education providers to thrive and build the skills needed for the future of our community and the economy, and to support Australia's critical export market in international education.

This year's Budget has announced increased Commonwealth investment in the school system, with the commitment of $1.2 billion for schools over 4 years from 2017 – 18 and new funding for students with a disability.

The Budget revealed that the government has delayed the implementation of the higher education reforms announced in the 2014 – 15 Budget by an additional year to undertake further consultation. This will result in savings of $2 billion over 5 years in fiscal balance terms and cost $600 million in underlying cash terms.

The government has announced that it will not proceed with the deregulated university fees.

There has been limited new investment in the higher education sector: $150 million in 2016 – 17 to continue to provide quality research infrastructure through the National Collaborative Research Infrastructure Strategy; $10.1 million over 4 years from 2016 – 17 to build the capacity of the Tertiary Education Quality and Standards Agency (TEQSA); and $8.1 million over 4 years to improve the information available to students through the *Quality Indicators for Learning and Teaching* (QILT) website.

Elise Wherry

National Sector Leader, Education

"The education sector lies at the heart of our future innovation. Providers need clear and stable policy and investment to deliver the skills and ideas our country needs."

New investment of $12 million over 4 years from 2016 – 17 to support implementation of the National Strategy for International Education is particularly welcome considering the importance of the sector to Australia's economy.

The Budget also announced funding to implement an enhanced compliance regime for VET FEE HELP to crack down on poor quality providers and protect vulnerable students and the reputation of the national vocational education and training sector.

Key announcements	Cost $ million	Comment
School funding	$1,200	Important boost for the sector
Research infrastructure	$150	Essential infrastructure investment
Funding for students with a disability	$118	Boost to current loadings
International Education Strategy	$12	Key new investment

Key insights

- As the Turnbull government has delayed higher education deregulation and reform, universities and other higher education providers face a challenging environment. Higher education providers will find it difficult to plan for growth and innovation while they have limited ability to increase their revenue.
- Considering the international education sector's importance to the Australian economy, as our third largest export (generating revenues of $18.8 billion to our GDP in 2014 – 15), the new strategy and funding commitments are welcome developments.
- Increased Federal funding for schools, indexed at 3.56 percent, is an important development for the sector and will undoubtedly be a key election issue. The new conditions imposed on the States have not previously been agreed, meaning that this funding is a substantively different proposition to the needs-based funding approach of Gonski.

Defence

As expected, the Federal Budget confirms the commitment made in the 25 February 2016 Defence White Paper, increasing defence expenditure to 2 percent of GDP by 2020 – 21.

The government plans to spend $33.9 billion in FY16/17 a 3.4 percent increase compared to its FY15/16 Federal Budget Statements which estimated $32.8 billion in total spending.

The Budget features a number of previously announced major capital outlays in the naval shipbuilding sector totalling nearly $90 billion. Compared to Air, Land and Joint program spending this maritime investment consumes the larger share of the $195 billion assigned to new defence capability through to 2025 – 26.

The critical Naval Shipbuilding Plan describing how some 3,600 defence industry jobs in Adelaide and Henderson will be secured by these investments, is still absent. The future for Victoria's Williamstown shipyard remains uncertain, no defence projects are earmarked.

Confirmed projects	Budget	Comment
Submarines	$50 billion	12 new boats
Frigates	$35 billion	9 new ships
Offshore Patrol Vessels	$3 billion	12 new ships
Pacific Patrol Boats	$1-2 billion	19-21 new ships

Steve Clark

National Sector Leader,
Defence & National Security

"The Defence White Paper promise has been confirmed – we now know additional resources will be available in the near term – it's up to Defence and industry to collaborate and respond."

$1.6 billion of additional funding has been committed through to 2025 – 26 for a series of Defence Industry Programs, including a new Centre for Defence Industry Capability based in Adelaide, a virtual Innovation Hub and Next Generation Technology Fund.

Additional funds of $615.8 million in 2016 – 17 have been provided for major operations supporting some 2,500 deployed ADF personnel including those in Syria and Afghanistan.

In the national security sector there has been a re-allocation of $195 million to implement recommendations of the recent cyber security review.

The new submarine program has passed a major milestone with the announcement of French company, DCNS, as the successive bidder.
The estimated cost of the program is approximately $50 billion and reflects the single most expensive Defence investment in Australia's history. What's more, the government has committed to building all 12 ships in Adelaide.

Key insights

- This Federal Budget confirms announcements made in the 25 February 2016 Defence White Paper and Industry Policy Statement - there are no new major announcements.
- Since the Defence White Paper, a series of naval shipbuilding announcements totaling some $90 billion in new investment have been announced. For defence, industry maritime represents the single largest opportunity space - time to reset strategic direction if this is not currently a target.
- An innovative, high technology Defence Industry is required to deliver this extensive program of work. $1.6 billion for Australian defence industry development offers a mechanism to jump-start growth.

Overview of changes

The main contributors to the changes in Revenue and Expenditure for 2016 – 20 as outlined in the Budget papers.

Top 10 Revenue contributors/expenditure savings

2016 – 20	$ billion
Increase Tobacco Excise	4.7
Establishing the Tax Avoidance Taskforce	3.1
Superannuation concessional contributions	2.4
National Disability Insurance Scheme Savings Fund	2.2
Introduce a $1.6 million superannuation transfer balance cap	2.0
Higher Education Reform	2.0
Public Sector Efficiency Dividend	1.3
Aged Care Provider Funding	1.2
Jobs for Families Package – deferral	1.1
Medicare Benefits Schedule – pause indexation	0.9

Top 10 Revenue reductions/expenditure increases

2016 – 20	$ billion
Personal income tax relief	(4.0)
Public Hospitals – new funding	(2.9)
Reducing the company tax rate to 25%	(2.7)
Increase the small business entity turnover threshold	(2.2)
Introducing a Low Income Superannuation Tax Offset (LISTO)	(1.6)
Tax deductions for personal superannuation contributions	(1.0)
School Funding – additional funding from 2018	(0.9)
Increase the unincorporated small business tax discount	(0.5)
Operation Okra – extension (Defence)	(0.4)
Allow catch-up concessional superannuation contributions	(0.4)

Announced but unenacted measures

The tables below summarise the status of potential legislation on announced but unenacted tax and related measures.

	Listed for introduction in Parliament until 12 May
1	Managed investment trusts
2	Innovation – Tax incentives for investors
3	Innovation – Similar Business test for tax losses
4	Innovation – Depreciation for tangible assets
5	Innovation – Crowd-Sourced Funding
6	GST – non residence and digital services
7	New treatment of fringe benefits for family assistance and youth
8	Pension means testing arrangements
9	Implement the Trans-Pacific Partnership of trade in goods
10	Budget Appropriation and Supply

	Measures that have not made it to Parliament/Legislation
1	Debt/equity tax rules – limit the scope of integrity rule (2011-12 Budget)
2	TOFA foreign currency regulations – technical and compliance saving amendments (2004 – 05 MYEFO)
3	TOFA tax hedging rules – technical amendments (2011 – 12 Budget)
4	Extend functional currency rules to trusts and partnerships (2011 – 12 Budget)
5	Charities – restate the 'In Australia' requirement for tax exempt entities and deductible gift recipients
6	Superannuation – penalties for promoting early release schemes (2011 – 12 Budget)
7	Amendments to Private and Public Ancillary Fund guidelines
8	Changes to insolvency laws & director personal liability
9	New tax treaty between Germany and Australia
10	Asia Region Funds Passport's Memorandum of Co-operation

	Not listed for introduction in Parliament by 12 May
1	Remedial power for the Commissioner of Taxation
2	Retrospective reduction: Reduced R&D tax offset rates for first $100m spend
3	Superannuation – Choice of Fund, Transparency measures
4	Life Insurance Remuneration Arrangements
5	Double dipping of employer and government schemes, paid parental leave
6	Introduce a new Child Care Subsidy

CFO / Head of Tax checklist

Detail		checklist
1	**Changes in tax rates** • Deferred tax impacts. • Dividend franking impacted by phased reductions.	☐
2	**Voluntary Tax Transparency Code** • Consider reputational and commercial factors in determining whether/when to adopt. • How might this interact with your Country by Country reporting obligations?	☐
3	**Multinational Enterprises – Targeted anti-avoidance measures** • Review existing / new structures and financial instruments to identify: • Potential Diverted Profits Tax exposures from 1 July 2017 • Arrangements which may be impacted by anti-hybrid rules from as early as 1 January 2018 • Consider changes needed to existing arrangements	☐
4	**Tax governance and ATO engagement** • Evaluate tax risk governance framework and controls in light of the ATO's 2015 tax guidelines. • Robust tax risk controls are needed to mitigate risks of increased penalties applying (e.g. non-lodgment).	☐
5	**Tax changes impacting M&A activity** • FIRB - Be ready for increased disclosure and ATO scrutiny to secure FIRB approval. • Incorporate tax consolidation changes into modelling for tax cost setting outcomes.	☐
6	**Small business** • When will phased corporate tax rate reductions apply to your business? • Various concessional tax measures extended to small business with <$10 million turnover • Monitor proposed changes to private company loan rules from 1 July 2018.	☐
7	**New CIVs – Fund managers, A-REITS, Infrastructure and other funds** • Commence planning for new product opportunities in conjunction with Australia's adoption of the Asia Funds Passport regime.	☐
8	**Superannuation changes** • Consider impacts on salary packaging and remuneration strategies. • Communication to employees. • Need to consider consequences for defined benefit plans.	☐
9	**Mandatory disclosure of aggressive tax schemes** • Monitor the proposed Mandatory Disclosure Rules to identify any affected arrangements.	☐
10	**Trade and customs** • Identify tariff reductions expected following ratification of Trans-Pacific Partnership Agreement. • Importers and exporters should consider customs duty deferral and mutual recognition opportunities.	☐

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