FEDERAL BUDGET 2018

What the Federal Budget means for Small Business

FEDERAL BUDGET OVERVIEW

Our Group Economics View

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As expected, the centrepiece of this Budget is increased infrastructure spending (currently put at $24.5 billion over 10 years), reductions in both personal and company tax and the Baby Boomer package (aimed to allow pension aged residents to fund their retirement in their own homes). Also we have the government committing to a tax to GDP ratio of 23.9% (likely to be triggered by around 2021/22). The latter is largely political but probably means that without significant spending restraint (unlikely in our view) future surpluses will be marginal. Hence there is little to no room for the Budget to adapt to any economic downturn while retaining the projected surplus - and indeed little macro policy flexibility.

On infrastructure a long list of projects including: a 50% share in a Western Sydney Airport rail link, Melbourne airport rail, Monash Rail link and finishing the Melbourne ring road, Metronet in Perth, Queensland roads and Adelaide road and rail spending and a congestion fund to address hot spots. Much of this is back ended and some may not go ahead (e.g. the Victorian Government has not committed to matching funding of the $5 billion Melbourne to airport rail link).

On personal tax cuts, as expected the cuts begin modestly and are aimed at the lower income levels. Initially this sees a new tax offset at $530 (around $10 per week for lower income earners). Phase two - in 2023/24 - sees the bottom two tax brackets increased to $41,000 (was $37,000) and $120,000 (was $87,000) and the old tax offset increased by $200. Phase 3 - in 2024/25 - sees the top bracket increased to $200,000 and the old 37% bracket abolished. As such the 2018/19 measures are unlikely to add much to growth. However dropping the Medicare levy increase to fund NDIS is more substantial and should help consumption growth from mid-2019 (albeit that has already been baked into our forecasts). Hence we have not changed our consumption and GDP forecasts out to 2019/20.

The Government continues to try to pass the company tax cuts for firms with more than $50 million turnover per annum. Clearly whether this gets through is another matter - with the politics not looking favourable. On the impact of company tax cuts our research based on the NAB Survey very clearly points to the main impact of tax cuts being in the first instance directed to increased investment (See Australian Economic Outlook) but in the short term really involves a switch from corporate to personal taxes (given our imputation system).

Elsewhere the Government is spending much more on a crackdown on the black economy (including outlawing cash transfers above $10,000), airport security, the PBS and has extended the immediate asset write off for small business investments of less than $20,000.

The government has brought forward its projection of a return to surplus in 2019/20 (really a flat outcome given the uncertainties) and a small surplus in 2020/21. At this stage we remain somewhat sceptical about the projections - if nothing else there is clearly an "election cycle of promises" still to go. In the "Medium Term Economic Outlook" our view is that the Budget implies a further slight weakening of the current structural tightening in the next few years (and we don't really return to structural - as against a nominal- surplus for some time - i.e. post 2020/21). Put differently revenue continues to be the main driver of the Budget and the medium term surpluses rely on more strict expenditure control than anything we have seen recently.

Overall we don't see this Budget as a big spending pre-election give away. That means the Budget will provide scope to spend more - and both sides of politics will almost certainly do so. The Contingency reserve is around $21 billion.

On the forecasts, there really aren't a lot of differences between NAB and Treasury - at the margins we are a touch weaker in 2019/20 on growth and nominal GDP but there is not really much in it. Notably the Government is more conservative than the RBA projections - and on unemployment in 2018/19 is closer to our forecasts than the RBA.

The underlying cash deficit is expected to fall from $33.2 billion in 2016-17 to $14.5 billion in 2018-19, then achieving a tiny surplus in 2019/20 (ahead of schedule but…) and building to near 1% of GDP in the out years.

As noted above there is little fundamental difference between Treasury's and NAB's economic forecasts - our GDP forecasts are around 2¾% over the next two years moving down to 2.6% in 2019/20 - while the Treasury numbers are 2¾% in 2017/18 and around 3% beyond that. Our profile sees infrastructure spending and business investment (especially for non-mining) adding to growth – as will, in the very near term, LNG exports. However, we still worry about the consumer who we expect will remain very cautious. As noted above we are marginally more cautious on wages and nominal GDP in 2019/20. And hence the surplus result in 2019/20 should really be seen as "flat"- a lot of water has to go under the bridge before we get to the surplus.

There was little discernible market reaction to the Budget. S&P has so far maintained its negative watch on Australia's AAA rating. Equally it will be interesting to see how much further spending will be rolled out in the election cycle. Already it has been confirmed that there will be a "Women's" Budget in the spring.

KEY INITIATIVES - SMALL BUSINESSES

SMALL BUSINESS GROUPS' AGENDA FOR REFORM

Each year, business organisations set out a wish list of potential reforms as part of their pre-budget submissions. This year, the list of recommendations included a range of ideas including:

- **Extension of instant asset write-off**: Extend the $20,000 instant write-off for equipment purchases beyond June 2018 (perhaps even permanently). This has been a highly popular, practical measure that has resulted in a high adoption rate among SMEs. Some groups are also lobbying for a higher value write off than $20,000 with the small business ombudsman calling for small business to have the ability to claim up to $100,000 once every three years to enable the purchase of more expensive equipment.
- **Corporate Tax Cuts**: Currently businesses with a turnover of less than $25 million have a tax rate of 27.5%. The Government plans that by 2026-27, the rate will fall to 25% for all businesses with a turnover less than $50 million. Small business groups have welcomed these initiatives, but are looking for a quicker timetable for implementation as they expect these measures to help boost investment, employment and improve cash flows. Some small business groups have also called for tax cuts to be extended to larger business to further support investment and potential opportunities for small businesses. Recent NAB research (NAB Quarterly SME Survey Q1 2018) showed that almost 3 in 5 (58%) SMEs believe a tax cut would better secure their business prospects, with the most significant impact on their business investment. A similar view was shared by bigger businesses (surveyed in the NAB Quarterly Business Survey), who also said the major initial impact of a tax cut was likely to be on business investment.
- **Training, Education & Employment**: Training and education are high-priority areas for SMEs. COSBOA has called for the New Enterprise Incentive Scheme (NEIS) to be expanded to include students and enhancing Vocational Educational Training schemes to more specifically address the needs of small business (e.g. more apprenticeships for younger workers and retraining opportunities for older employees). Also highlighted was the need to reinvest in a new 'National Employment Network' - an independent body which would develop a national employment strategy in concert with industry, local and regional stakeholders. The cost and delays around skilled migration was also flagged as an issue. The most recent NAB Quarterly SME Business Survey found that it's becoming more difficult for SMEs to find suitable labour. In fact, finding suitable labour is now the second biggest constraint on output for SMEs (just behind demand), continuing the upward trend that started in mid-2015.
- **Start-ups:** Small business groups have called for increased support for entrepreneurs in the areas of tax and access to capital to help them overcome financial impediments in commencing a business. Although the 2017 budget delivered some assistance for Australian start-ups, the sector had hoped for more, building on the Government's Innovation Agenda. Some potential areas of opportunity identified by the start-up community include: education and skills training/re-training in an increasingly automated and digitised world; more attractive tax concessions for start-ups who reward their staff through employee share schemes; and specific R&D incentives for start-ups.

- **Procurement and Payments**: A stronger commitment from all government agencies to ensure that SMEs are paid on time to avoid hurting cash flows. There has also been a push for SMEs to have greater access to government contracts, with some groups calling for a firm target and greater transparency, as in the United Kingdom.
- **Business Simplification**: Further progress on simplifying the tax system, especially in regards to BAS (Business Activity Statements), as well as general administration. For example, COSBOA identified the burden of collecting superannuation, the complexities of parental leave payments and greater support in the areas of maternity leave and domestic violence leave.
- **Representation:** Greater SME representation in key government bodies such as ASIC and Reserve Bank Board, and greater prominence of the sector at a ministerial level.
- **Other**: There were a range of other ideas including: access to more affordable and higher-speed internet; a reduction in the cost of electricity for business; simplification of GST; and more generous incentives for energy efficient technologies.

WHAT THE BUDGET ACTUALLY DELIVERED

Extension of the instant asset write off scheme: A further 12 month extension until 30 June 2019 of the $20,000 instant asset write-off for businesses with aggregated annual turnover less than $10 million. This allows small businesses to immediately deduct purchases of less than $20,000.

A continuation of the 10-year Enterprise Tax Plan: The 27.5% tax rate, which applied to businesses with turnover up to $10 million in the 2017-18 Budget has been expanded to cover businesses with an annual turnover of up to $50 million. Further, the unincorporated small business tax discount rate has been increased from 5% to 8% (up to a cap of $1,000). This rate will increase further to 16% by 2026-27. Concurrently, the turnover threshold has also been raised from $2 million to $10 million.

Tackling the Black Economy: The Government will address fraudulent invoicing, sham contracting and non-compliant payment deductibility, and large cash payments.

- Fraudulent Invoicing: The Government will expand Taxable Payments Reporting System (TPRS) to include sectors such as security and investigation services, road freight and computer system design and related services. Currently the TPRS only applies to the building and construction industry, and from July 2018 cleaning and couriers.
- Sham Contracting and non-compliant payments: Businesses will no longer be able to claim tax deductions if they have not withheld Pay As You Go (PAYG) even though PAYG requirements exist.
- Economy wide cash payment limit: From 1 July 2019, the Government will introduce a limit of $10,000 where cash is used for goods or services.
- Tobacco excise evasion: the Government expects additional revenue of $3.6 billion over the forward estimates by combatting smuggling, warehouse leakage and domestic production.

Changes to R&D Tax Incentives: There are significant changes to the R&D tax incentive (R&DTI). From 1 July 2018 the Government will introduce for companies with a turnover of less than $20 million, a refundable R&D offset premium of 13.5 percentage points above the company's tax rate, with the offset capped at $4 million per annum. For companies with turnover of more than $20 million, the government will introduce an R&D premium that ties the tax offset to the intensity of R&D expenditure.

Simpler BAS & Business Registration: GST reporting has been streamlined for small businesses The government has simplified Business Activity Statements by reducing the 20-question requirement down to three questions. It's estimated to save small businesses an average of $590 per year. Furthermore, $92.4 million will be provided in 2018-19 to fund the next stages of the Commonwealth digital ID solution (GovPass). As part of the funding, approximately 100,000 tax file number applications will be completed online.

More Protection for Businesses: The Government will implement new measures to counter illegal phoenixing - i.e. where a new company is created to continue the business of a company that has been deliberately liquidated to avoid paying its debts. For example, company directors will be prevented from improperly backdating resignations to avoid liability or prosecution and resigning when this would leave the company with no directors.

Additional protection has been given to SMEs by extending unfair contract term protections. In addition, the new Australian Financial Complaints Authority will help give more small businesses access to quick and cheap dispute resolution processes.

Up-skilling Australians: $250 million (allocated in last year’s Budget) to be provided to the Skilling Australians Fund.

The Government will also provide $189.7 million over five years to support mature age workers that are registered with a JobActive provider and $19.3 million over three years to help workers aged 45–70 to transition into new roles.

Energy Policies: The Budget has set aside $41.5 million to implement its energy policies, including the National Energy Guarantee and outstanding measures from the Finkel review of energy security. The availability of energy data will help Australian consumers and businesses shop around and get a better deal from their power supplier. The Budget anticipates possible savings as much as $400 from a typical household's power bill.

OTHER KEY BUDGET MEASURES

Infrastructure & Transport

The 2018-19 Budget provides for significant new infrastructure spending, committing an additional $24.5 billion to take the Commonwealth's commitment to $75 billion for transport infrastructure over the coming decade. While last year's budget focussed on Commonwealth-owned projects such as Inland Rail and Western Sydney Airport, new spending in this budget is aimed at state government delivered road and rail projects, largely in congested urban areas.

Victoria is arguably the biggest winner, with $7.8 billion earmarked for projects in the state. This includes $5 billion for a rail line to Melbourne Airport (but importantly as an equity investment and contingent on matched funding from the state government), $1.8 billion for North East Link, $475 million for a Monash rail, $225 million to electrify the Frankston line to Baxter, $140 million for a congestion package, $132 million for Princes Highway in Gippsland and $50 million for Geelong line upgrades.

There may be some tension with the Victorian Government over the airport line, given that the funds may be continent on Commonwealth equity investment and that a final route is yet to be selected (a $10 billion project likely to be the most expensive of potential options). The state has separately commissioned its own study of airport rail route options including Geelong fast rail.

New South Wales will receive an extra $1.5 billion for new projects, including almost $1 billion for Pacific Highway to bypass Coffs Harbour and $400 million for upgrades to the Sydney freight rail network. The Commonwealth will additionally be a 50% partner in the new North South rail link.

Queensland will receive $5.2 billion, including $3.3 billion for the Bruce Highway, $1 billion for the Pacific Motorway and $390 million for railway duplication to Nambour, $300 million for the Brisbane Metro and $170 million for the Amberley Interchange.

Western Australia will receive $2.6 billion including an additional $1.1 billion for Perth Metronet, almost $1 billion for Perth congestion and $560 million for a Bunbury ring road. South Australia is poised to gain $1.8 billion, including $1.4 billion for the North-South Road and $220 million for Gawler line electrification. Tasmania will receive $461 million for a new Bridgewater Bridge, the ACT will receive a $100 million upgrade to the Monaro Highway and the NT will receive $280 million for road upgrades.

Education

There was little in the way of new funding for the education sector in this year's budget - with headline spending of an additional $24.5 billion over ten years in needs-based funding already announced in the 2017-18 MYEFO.

Overall, vocational and other education expenses are expected to decrease in real terms by 1.4% between 2017-18 and 2018-19, and by a further 3.1% between 2018-19 and 2021-22.

Higher education funding is expected to decline by 1.4% in real terms over the 2 years to 2018-19, and by 1.8% over the 4 years to 2021-22.

School funding, on the other hand, is expected to improve, rising by 4%, in real terms, over the 2 years to 2018-19. Further down the track, a 12.4% real increase in school funding is anticipated over the 4 years to 2021-22. Most of these funding changes were announced in last year's budget.

The Government has provided an additional $247 million over four years from 2018-19 to extend the National Schools Chaplaincy Programme.

Regional and rural education will be supported by $96.1 million over 4 years to help regional school students avail of tertiary study or work.

There were no significant changes to childcare arrangements - with changes to payments and the extension of funding for four year old pre-school already announced.

Early childhood education receives $440 million which will be used to expand on the Universal Access to Early Childhood Education program till the end of 2019.

Science & Innovation

A national accurate satellite based positional, navigation and timing (PNT) capability will see funding of $224.9 million over 4 years. Additionally, Digital Earth Australia which provides access to standardised satellite data will see $36.9 million in additional funding over 3 years ($12.8 million each year after) on top of the $15.3 million provided in the 2017-18 Budget.

In addition, $41 million over 4 years will be allocated to growing the Australian Space Industry with $26 million over 4 year going towards establishing a National Space Agency and $15 million over 3 years to the International Space Investment project which will provide grants to strategic space projects.

Investments into new industries and digital technologies will see a $29.9 million investment in Australian's artificial intelligence (AI) and machine learning capability with a Technology Roadmap, a Standards Framework and a national AI Ethics Framework.

A further $45m of funding will be invested over 4 years to establish a Consumer Data Right as a safer way for consumers to share and use their data. The Consumer Data Right will commence with selected large sectors and will eventually apply economy-wide. In conjunction with the establishment of Consumer Data Right, a National Data Commissioner will also be established to oversee the Government data systems and integrity.

Health & Aged Care

Public hospitals will receive an additional $30 billion in funding between 2020-21 and 2024-25 (albeit much of this spending is beyond the Budget estimates period). This measure was announced following the COAG meeting in February 2018.

New and amended listings on the Pharmaceutical Benefits Scheme will receive $1.4 billion over five years, including medicines to treat spinal muscular atrophy, breast cancer, refractory multiple myeloma, and relapsing-remitting multiple sclerosis, as well as a new medicine to prevent HIV. The increased use of generic and bio-similar medicine is expected to generate savings of $336 million over this period.

The Government will spend $1.3 billion over 10 years from 2017-18 to support growth in the healthcare sector under the National Health and Medical Industry Growth Plan. The vast majority of this spending is scheduled to occur after 2021-22, with much of the funding coming from the Medical Research Future Fund.

The Government will also provide $154 million to promote active and healthy living, including $83 million to improve existing community sport facilities, and to expand support for the Sporting Schools and Local Sporting Champions programs.

The Government will spend $1.6 billion over the four years from 2018-19 to fund an additional 14,000 high-level home care packages (from the 6,000 packages announced in the 2017-18 MYEFO).

Agribusiness

This budget contains relatively few changes for agriculture. The $20,000 instant asset write-off has been extended to 30 June 2019, which may help with some equipment purchases. There is $225 million over 4 years for GPS and satellite technology access, which will improve access for some modern agricultural equipment. Further funding is also provided to assist agriculture exporters.

To improve biosecurity, there will be a new levy of $10.02 per 20ft container equivalent and $1/tonne for bulk cargo. This is forecast to raise $360 million (on fiscal balance terms) over the forward estimates.

Housing

The Government will spend $550 million over the five years starting 2018-19 to improve access to housing for indigenous residents in remote Northern Territory. This measure was announced in April 2018 and funding will be matched by the Northern Territory Government.

NAB'S VIEW & INDUSTRY REACTIONS

Small business is the backbone of our economy and our communities - there are over 2 million small businesses in Australia employing more than 4.7 million people.

SME business conditions are currently at their level highest level since 2008 and well above its historical average (NAB Quarterly SME Business Survey Q1 2018).

The Treasurer recognised the importance of small business as one of the government's top 5 priorities to further strengthen the economy. He added the 2018 Budget must "keep backing business to invest and create more jobs, especially small and medium sized business."

But in reality, it has fallen somewhat short of the high hopes that small business groups had for this Budget.

Although the decision to extend the popular $20,000 instant asset write off was welcomed, those that had pushed hard to make a permanent fixture will be disappointed, as will those that had hoped the write off amount might have been lifted.

That said, the extension should continue to support cash flows for many small businesses (at least for another 12 months), and in turn help them reinvest in their business and replace or upgrade assets. Improved cash flow could also provide them with greater flexibility around employment and benefits.

The extension will also allow for those small businesses that did not have the cash available previously to take advantage of the scheme and to plan for future asset purchases.

The corporate tax cuts already announced in the Government's Ten Year Enterprise Plan are welcomed. But, the Government must still negotiate the remainder of these cuts through the Senate. Those looking for a quicker timetable will be disappointed.

The small business entity turnover threshold has also been extended from $2 million to $10 million. This will give more businesses access to a range of small business tax concessions.

While R&D intensive businesses with more than $20 million a year in revenue will directly benefit from changes to the R&D tax incentive scheme, there is a cap for smaller businesses and hence less incentive. This is a disappointing result for Australia's start-up community.

The announcement of a suite of new measures in the budget to "shine a light on the black economy" builds on the Government's "Black Economy Taskforce". These new measures are welcomed and should benefit the vast majority of honest small businesses by levelling the playing field.

While not directly targeting small businesses, a number of other budget measures should be of benefit to small business. In particular, the cuts in personal taxes will be well received by many small businesses because of the potential flow through effects of higher disposable income on consumer spending - an area of the economy that has been weak in recent years. Small businesses will however need to keep in mind that consumer spending has been weighted towards 'essential' spending such as utilities, medical expenses and paying off debt which may limit the flow through to some small businesses. The impact of slowing house prices and modest wage growth could also be limiting factors.

The promise of massive infrastructure investment for road, rail, and project building could be a boon for small business by creating potential work for SMEs involved in construction, building and associated services. New infrastructure spending could provide further opportunities for many small businesses as more money is spent in areas where projects are being undertaken (e.g. food retailers, hospitality etc.). Longer-term benefits of new infrastructure for SMEs will also include improved access to retail and other services.

But, those small businesses eyeing the proposed $5 billion rail line to Melbourne Airport may yet be disappointed given that the funds might be contingent on Commonwealth equity investment and that a final route is yet to be selected.

The Vocational Education Sector has not received any material additional funding - something which will be a source of disappointment for many small businesses.

Finally, aside from greater transparency around energy data, there was little mention of how to handle the rising cost of energy for business, a source of concern for many small businesses.

INDUSTRY REACTIONS

According to the Australian Industry Group (AIG) **the "Federal Budget will give business and the community confidence for the future and is cause for optimism."** They also commended the Government for taking **"advantage of the economic improvement now underway by proposing tax relief to business and households, as well as a significant boost to infrastructure spending. This strategy is anticipated to drive further growth in activity, real incomes and job creation."** However, AIG believes the national challenge lies with the skill shortage and **"there is clearly room for more investment in skills than is planned."**

The Australian Small Business and Family Enterprise Ombudsman welcomed the Government **"working towards a level playing field for small business."** The Ombudsman believes new initiatives such as limit the ability of directors to resign when this would leave the company with no directors that targets tax avoidance and illegal phoenixing by **"will empower small businesses who are doing the right thing to compete."** Additionally, the Ombudsman noted that **"the Government's focus on apprenticeships, traineeships and the mature aged workforce will provide a wider pool of resources, and the continuation of the instant asset write-off is welcome."**

The Australian Chamber of Commerce and Industry (ACCI) said that **"the Federal Budget is heading in the right direction"** but lamented **"the lack of ambition for long term budget repair in case the global or domestic economic outlook proves weaker."** Overall, the ACCI welcomed the Budget's delivery of personal tax cuts & the course to deliver business tax cuts, the extension of instant asset write-downs for small business and investment into greater connectivity between regional and metropolitan Australia. However, the ACCI were less welcoming on the qualified approach to funding for Skilling Australia, the negative targeting of R&D tax incentives and lack of greater ambition for budget repair that is overly reliant on growth in tax receipts but not addressing waste and inefficiencies in spending.

The AMA labelled the Health Budget as **"safe and steady"**, but added that it was notable as much for what was not to be found in it as for what was included. The establishment of a new 21st century medical industry plan to create more jobs and support more medical research projects, was viewed as a **"major commitment"**. They also welcomed **"the Government's strong focus in this Budget on improving access to doctors in underserviced communities, particularly rural Australia".** But, the AMA also noted that **"some of the bigger reforms and the biggest challenges are yet to come".**

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