



A stylized illustration of a tablet device. The screen shows a dashboard layout. On the left, there is a blue rectangular chart at the top, followed by three horizontal grey bars of varying lengths, and a small magenta square at the bottom. On the right, there is a donut chart with four segments in blue, purple, pink, and dark blue. Four grey lines radiate from the donut chart towards the corners of the screen. At the bottom of the screen, there are three horizontal grey bars. The tablet has a dark grey bezel and a circular home button on the right side.

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Executive summary

Turning the corner towards a balanced budget

The government's fiscal strategy of balancing the Budget by 2020-21 has been assisted with upgrades in global and domestic growth forecasts coupled with new revenue measures (e.g. a bank levy plus a Medicare levy increase).

This has enabled the government:

- To jettison earlier commitments on expenditure cuts the Senate had refused to endorse, in favour of more modest proposals (e.g. higher education changes).
- Announce new spending initiatives directed at either enhancing growth and job prospects or improving vital government services (e.g. building a second Sydney Airport, developing regional rail infrastructure and a new school funding model).

The government is now making the case that in a low interest rate environment it is acceptable for it to lock in long term financing to then invest in assets that will be income enhancing, albeit with very long lead times and high risks. Accordingly, we are now seeing greater transparency in budget reporting with a distinction being made between capital and recurrent expenditure. In KPMG's 2015 tax reform submission we argued the manner in which Federal Budgets were framed significantly shapes the discourse on taxation and expenditure. We had recommended three new sets of government accounts, including a set of current revenue and infrastructure accounts. We are therefore pleased to see budgetary transparency initiatives are now being embraced.

Other key decisions in the Budget include:

- Health: changes to the Medicare Benefits Schedule and Pharmaceutical Benefits Scheme, and ensuring the funding of the National Disability Insurance Scheme.
- Housing package: the focus being on first home buyers and increasing the affordable housing stock.
- Further tax integrity measures: the government's initial response to the Black Economy Taskforce's interim report continues a zero tolerance attitude towards tax avoidance. In addition, legislative changes to combat base erosion, including the strengthening of multinational integrity measures, and goods and services tax changes, are to be implemented.

What does this mean for business?

The year-end focus for small-medium businesses will be on understanding if they are entitled to the recently announced company tax cuts (and when), as well as clarifying their interactions with franking, research and development incentives and the tax accounting impacts in their financial statements.

Larger businesses are left to wait and see whether the government's second attempt to legislate the entire package of company tax cuts receives any better hearing in the Senate.

In the meantime, pending government decisions on petroleum resource rent tax, stapled structures, incentives for research and development, new whistle blower rules as well as responding to calls for a deferral of the goods and services tax compliance regime for low value imports, means there is no shortage of important tax developments still in the pipeline.



Gary Wingrove
Chief Executive Officer



David Linke
National Managing Partner, Tax

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Chief Executive Officer

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National Managing Partner, Tax



Economic and fiscal analysis

The global economy is picking up, and so with it is the Australian economy.

The underlying economic forecasts contained within the Budget appear reasonable and are in a range consistent with our most recent forecasts contained within the March 2017 edition of the KPMG Quarterly Economic Outlook.

Growth in the Australian economy has been bolstered over the past year by high levels of production within the agricultural, mining and services sectors, which has also generated a significant uplift in profitability across virtually every industry. However, this strong profit growth has not translated into significantly higher company income tax receipts per the current year. This is most likely due to deductions for carried forward losses, which KPMG anticipates will still influence company income tax payments over the forward estimate period. The latest ATO statistics (for the 2014-15 financial year) reveal more than \$300 billion in tax losses to be carried forward into future income years, of which nearly \$100 billion are associated with companies within the mining industry alone.

Soft wages growth, higher levels of part time and casual employment and sticky unemployment have all contributed to expectations of low growth in personal income tax receipts over 2016-17. Treasury expect this growth to pick up gradually over the forward estimates, with very strong growth forecast in 2019-20 and 2020-21. At the same time the Budget is suggesting a slight reduction in GST receipts in 2019-20 as compared to MYEFO. Given this divergence it would be reasonable to question whether the Budget forecasts of personal income tax receipts in the later years are at the upper end of possible outcomes.

The Underlying Cash Balance (UCB) presented in the Budget is slightly worse by about \$1.8 billion in aggregate for 2016-17 and 2017-18 than forecast in MYEFO. From 2018-19 the UCB is forecast to improve dramatically, with a surplus of \$7.4 billion anticipated to be achieved in 2020-21.

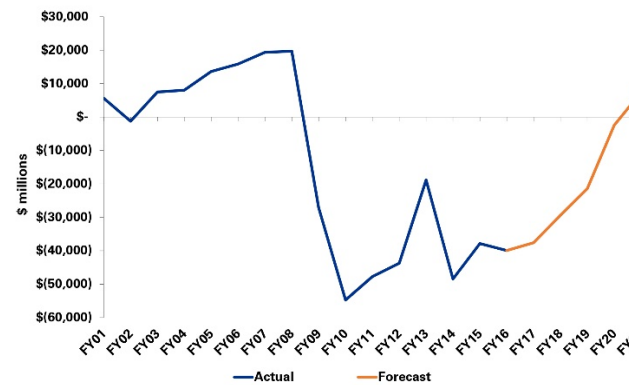
Given the underlying economic forecasts contained within the Budget do not indicate 'boom times ahead', and that current excess capacity within the Australian economy will take some time to be taken up, KPMG considers this forecast path to Budget repair proposed by Treasury may be at the optimistic end of the spectrum of outcomes.



Brendan Rynne
Partner, Chief Economist

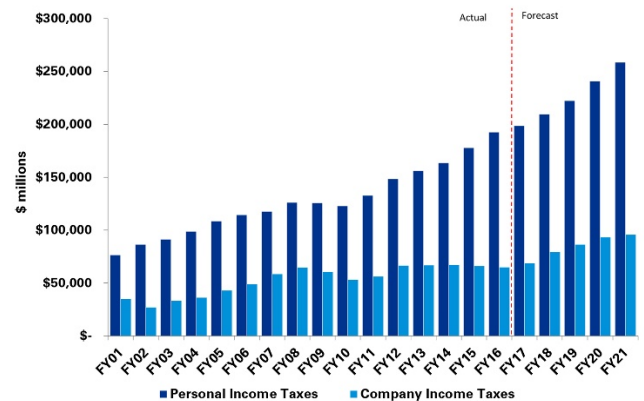
"The underlying economic forecasts contained within the Budget are reasonable, however, the path to Budget repair is potentially too optimistic in the out years."

Underlying Cash Balance



Source: Treasury, KPMG Economics

Personal Income Tax and Company Income Tax Receipts Actual and Forecast



Source: Treasury, KPMG Economics

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

	2016	2017	2018	2019	2020
GDP (Real)	2.7%	1.8%	2.9%	2.9%	3.1%

A negative GDP in the September quarter 2016 will act as a drag on the economic growth outcome for 2016-17. Continued production growth in the resources sector, solid growth in consumption, and increased public sector investment activity will underpin trend levels in economic activity in the forward estimates period.

Growth in real GDP	2017
United States	2.3%
Canada	1.9%
United Kingdom	2.0%
Japan	1.2%
China	6.6%

Unemployment rate – recovering very slowly

	2016	2017	2018	2019	2020
Unemployment	5.7%	5.4%	5.4%	5.2%	5.1%

Unexceptional economic growth and changing dynamics within the labour market, being an increased casualisation of the labour force, are resulting in weak employment activity. Underemployment remains a problem within the economy, and while this could improve as the economy strengthens, it will do so without pulling down the unemployment rate.

Unemployment rate	2017
United States	4.7%
Canada	6.9%
United Kingdom	4.9%
Japan	3.1%
China	4.0%

Consumer price index – within band

	2016	2017	2018	2019	2020
CPI	1.0%	1.5%	1.6%	2.1%	2.3%

Spare capacity within the Australian economy, both in terms of the labour market and production capabilities of firms, is keeping price pressure in check. Combined with a relatively stable exchange rate, inflation is expected to remain below or at the lower bound of the RBA target band for the forward estimates period.

CPI	2017
United States	2.7%
Canada	2.0%
United Kingdom	2.5%
Japan	1.0%
China	2.4%

Public net debt as a percentage of GDP

	2016	2017	2018	2019	2020
Public net debt	19.9%	20.9%	20.8%	20.0%	18.6%

Continued budget deficits, combined with increased capital spending on infrastructure through traditional debt financing arrangements, will add to the Federal Government's net debt position.

Debt as a percentage of GDP	2017
United States	82.4%
Canada	26.4%
United Kingdom	80.4%
Japan	120.0%
China	n/a

Source: IMF



Housing Affordability

The housing affordability measures in the Budget are relatively modest and unlikely to have a major impact on housing affordability in Australia. Most of the measures announced in the Budget are aimed at boosting the supply of housing by encouraging either the development of new dwellings or more effective use of the existing stock of dwellings. This is particularly relevant for the heated property markets of Sydney and Melbourne.

The National Housing Infrastructure Facility (NHIF) is an initiative with the potential to boost the supply of new dwellings. The NHIF will be established with funding of \$1 billion over 5 years to provide local governments with access to concessional loans, equity investments and grants to help build infrastructure that will speed up the supply of new housing such as transport links, power and water networks and site remediation works. The Budget also outlines plans by the government to make under-utilised and surplus Commonwealth land available for housing.

To boost the supply of affordable rental housing, the Budget introduces a 60 percent capital gains tax discount to Australian resident individuals who invest in rental properties that are provided at below market rent to eligible tenants on low incomes. This concession will also flow through to Australian resident individuals who invest in such properties via qualifying 'affordable housing managed investment trusts'.

There are two main initiatives in the Budget that target more effective use of the existing dwelling stock. The first aims to facilitate downsizing by older Australians by allowing individuals aged 65 and over to make an additional non-concessional contribution of up to \$300,000 to their superannuation fund from the proceeds of the sale of a principal place of residence held for at least 10 years. The second initiative targets under-utilisation of dwellings by foreign owners. Foreign owners that do not occupy or

make their properties available for rent for 6 months or more each year will be charged an annual fee of at least \$5,000.

Foreign investors will also be impacted by two additional budget initiatives. First, a 50 per cent cap on pre-approved foreign ownership in new multi-storey developments with at least 50 dwellings will be introduced. The aim of this policy is to improve access to such developments for

Australian buyers. Second, foreign investors will be less able to avoid paying capital gains tax in Australia upon disposal of their investment in Australian property, with the introduction of more stringent capital gains tax rules, including an increase in the CGT withholding rate from 10 to 12.5 per cent and reduction in the threshold from \$2 million to \$750,000.

To assist first home buyers entering the property market, the government has introduced the First Home Super Saver Scheme, which will commence on 1 July 2017. The scheme allows first home buyers to use their superannuation fund as a vehicle to save for a house deposit. The concessional treatment of savings in superannuation vehicles allows first home buyers to build their deposit more rapidly.

The Budget also introduces several measures to support the community housing sector and to improve outcomes in social housing and homelessness, although the detail is limited at this stage.

KPMG's overall assessment of the package of measures in the Budget is that they will improve housing affordability in Australia, although the markets where the problem is most acute, Sydney and Melbourne, are unlikely to get much relief in the short term. The measures aimed at boosting supply are likely to have the greatest impact in moderating house price growth. The First Home Super Saver Scheme allows first home buyers to more effectively compete for property against investors, but it is unlikely to help moderate price growth.

KPMG has recognised that the housing affordability problem is complex and that a solution must encompass supply and demand side initiatives. The problem cannot be fixed overnight and will require policy co-ordination from all tiers of government and co-operation with the private sector. KPMG sees the measures contained in the Budget as broadly constituting a positive step forward, but additional policy initiatives – including tax reform – will be necessary to tackle this complex issue.

Key insights

- Various initiatives have the potential to boost the supply of dwellings, such as the NHIF, the Western Sydney City Deal, making available under-utilised Commonwealth land and the non-concessional contributions for individuals aged 65 and over.
- Additional measures specifically target foreign investors through the annual fee on under-utilised dwellings, the cap on foreign owned dwellings in multi-storey developments and the introduction of more stringent capital gains tax rules.
- Further measures to support the provision of affordable housing include the 60% capital gains tax discount.
- First home buyers will benefit from the First Home Super Saver Scheme.



Personal tax

Temporary Budget Repair Levy

No announcement has been made to retain the Temporary Budget Repair Levy and therefore it will expire on 30 June 2017 as anticipated.

Fringe Benefits Tax rates

The FBT rate aligns to the top rate of income tax for individuals. The removal of the Temporary Budget Repair Levy therefore impacts the FBT rates (both tax rate and gross up rates) applicable from 1 April 2017 as follows:

- The Type 1 gross up rate has changed from 2.1463 to 2.0802.
- The Type 2 gross up rate has changed from 1.9608 to 1.8868.
- The FBT rate has decreased from 49% to 47%.

Medicare Levy increase

Government figures indicate that there has been an increase in funding requirements for the Australian healthcare system.

To address this, and to ensure that the National Disability Insurance Scheme is fully funded, the Budget has sought to increase the Medicare Levy from the current rate of 2% of taxable income to 2.5% from 1 July 2019.

Capital Gains Tax

Foreign and temporary tax residents will no longer have access to the CGT main residence exemption from 7.30pm on Budget night. Existing properties held prior to this date will be grandfathered until 30 June 2019.

This could impact Australians intending to sell an Australian main residence when living overseas.

Withholding tax of 10% currently applies to foreign tax residents with real property sales proceeds of over \$2 million. Under this Budget the withholding rate will increase to 12.5% and the threshold will decrease to \$750,000.

Housing affordability measure

Foreign owners of residential property acquired after 7.30pm on Budget night will be charged an annual fee equivalent to the foreign investment application fee at acquisition for any property in Australia that is neither occupied nor genuinely available for rent for at least 6 months of the year.



Ben Travers

National Leader, People Services

"It is welcome that the government has confirmed that the Temporary Budget Repair Levy is ending on 30 June 2017, despite speculation it may be extended due to the need for ongoing Budget repair."

Rental properties

From 1 July 2017 deductions against rental income will no longer be available in relation to travel costs to inspect or maintain the property, or collect rent.

In addition, depreciation deductions for plant and equipment in residential rental properties will be limited to outlays actually incurred by the investor. As a consequence depreciation can no longer be claimed against items in situ at the time of purchase (e.g. dishwashers, ceiling fans etc. installed by a previous owner). Grandfathering arrangements apply to existing investments as at 9 May 2017.

Student Loan repayments

The Budget has sought to tackle the \$52 billion in outstanding taxpayer funded student loans by dropping the compulsory repayment threshold from \$54,869 to \$42,000 from 1 July 2018. The starting repayment rate will also decrease to 1% (currently 4%) from the same date.

The repayment threshold will also be indexed to inflation from 1 July 2018, rather than the current benchmark of average weekly earnings.

Work-related expenses

Close to \$22 billion in work-related expenses were claimed in 2014-15, representing an increase of 21% over the past 5 years compared to wage growth of 21.8% and CPI growth of 12.2%. The ATO has indicated its concern overclaiming of work-related deductions by individuals represents a significant area of non-compliance.

Despite recent conjecture regarding the possibility of introducing a universal cap on work-related expenses, or a standard deduction akin to the US personal tax system, this Budget has not sought to address this issue.

Negative gearing

There has been much government discussion in recent months regarding ways to address housing affordability.

As anticipated, limits on negative gearing have not been introduced in this Budget.

The impacts of the Temporary Budget Repair Levy removal and the announced Medicare Levy increase on an individual are illustrated in the following example:

Item	FY17	FY18	FY19	FY20
Gross salary	\$200,000	\$200,000	\$200,000	\$200,000
Income tax	(\$63,232)	(\$63,232)	(\$63,232)	(\$63,232)
Medicare Levy	(\$4,000)	(\$4,000)	(\$4,000)	(\$5,000)
Temporary Budget Repair Levy	(\$400)	\$0	\$0	\$0
Total tax	(\$67,632)	(\$67,232)	(\$67,232)	(\$68,232)
Net income	\$132,368	\$132,768	\$132,768	\$131,768

Key insights

- The Temporary Budget Repair Levy ends on 30 June 2017.
- However, the 0.5% increase to the Medicare Levy increases the tax burden for most taxpayers from 1 July 2019.
- No changes have been made to deductions for work related expenses, despite speculation to the contrary.
- A number of other relatively small personal tax changes have been announced, although it is worth noting that the loss of CGT exemption for foreign residents on sale of their main residence could impact Australians residing overseas.





Business and international tax

Top 7 changes

1 MAAL Integrity Measures

The government will introduce targeted integrity measures into the Multinational Anti-Avoidance Legislation (MAAL), with retrospective effect to the date of the MAAL's commencement of 1 January 2016.

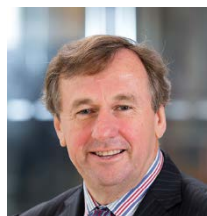
These changes target certain structures, undertaken by a small number of groups, which involved the use of foreign trusts and partnerships and were perceived to be sidestepping the intent of the MAAL legislation.

The ATO had already foreshadowed its concerns with these structures in Taxpayer Alert 2016/11, and the government has now announced it will directly counteract these structures by legislative means.

2 Non-resident CGT exemption tightening

The foreign resident capital gains tax exemption currently allows foreign residents to disregard capital gains from disposals of non-portfolio membership interests in entities, provided their underlying value is not principally derived from taxable Australian real property (the principal asset test).

The government has announced that, with effect from Budget night, this exemption will be tightened by requiring the principal asset test to be determined by reference to the entity being disposed of, and its associates. The intention of this amendment is to prevent foreign residents disaggregating indirect interests in taxable Australian real property to access the exemption.



Peter Madden

National Leader, International Tax

"Given the very significant recent changes from prior Budgets impacting the international tax framework, it is not surprising that this Budget represents a relatively 'light touch' for global multinationals. However, the practical impact of the recently-enacted Diverted Profits Tax, transfer pricing rules re-write and the upcoming Anti-Hybrid rules, is yet to be fully felt by taxpayers."

3 FRCGW integrity measures

The foreign-resident capital gains withholding (FRCGW) regime, which introduced a requirement for vendors to remit to the ATO a non-final withholding tax in respect of disposals of property to foreign residents entered into from 1 July 2016, will be amended in two respects from 1 July 2017.

Firstly, the rate of withholding will increase to 12.5% (from 10% as it currently applies). Secondly, the threshold for the application of the FRCGW will reduce to \$750,000 (from \$2 million).

Australian-resident businesses selling real property for a consideration of more than \$750,000 will need to obtain a clearance certificate from the ATO prior to settlement, to ensure they do not themselves incur the 12.5% non-final withholding obligation.

4 OECD hybrid mismatch rules for regulatory capital

In the previous Budget, the government announced it would move forward with implementing the OECD's anti-hybrid mismatch measures. These measures are to be implemented from the later of 1 January 2018 or 6 months following Royal Assent of the relevant legislation.

Although this Budget does not progress these measures any further for business generally, the government has now made it clear that there will not be any special accommodation for banks and financial institutions in relation to Additional Tier 1 regulatory capital. These proposed changes are discussed further in the Banking section.

5 Reducing Pressure on Housing Affordability — affordable housing through Managed Investment Trusts

The government is seeking to address the ATO's view that the yield on residential housing is insufficient to be classified as an investment which is made primarily for the purposes of deriving rental income by specifically allowing for MITs to invest in affordable housing where:

- the affordable housing is available for rent for at least 10 years and provided to low-to-moderate income tenants at a discount to the private rental market
- 80% of the income of the MIT is derived from affordable housing.

These changes, which will apply for income years starting on or after 1 July 2017, will be welcomed by the property sector, which has long been looking into establishing residential housing funds.

6 Reducing Pressure on Housing Affordability — expanding tax incentives for investments in affordable housing

The government is further expanding tax incentives for investments in affordable housing. From 1 January 2018, the CGT discount for resident individuals will be increased to 60% for qualifying investments in affordable housing.

To qualify for the increased CGT discount:

- housing must be provided to low-to-moderate income tenants at a discount below the private rental market rate
- the affordable housing must be managed through a registered community housing provider
- the investment is held and used for affordable housing for a minimum period of 3 years.



James Macky

National Leader, Tax Advisory Services

"Whilst businesses may well be relieved that this Budget has limited impact on the corporate income tax regime, it could also be seen as a further missed opportunity to enhance Australia's competitiveness, for instance through a broader reduction of the corporate tax rate."

The increased CGT discount will be able to flow through to resident individuals investing in qualifying affordable housing MITs (see above) and applies to new and existing properties.

These provisions, and the qualifying MIT provisions, will be subject to public consultation and the commerciality of the investment restrictions will be key to the provisions' success.

7 Black economy - prescribed payments to couriers and cleaners

The Taxable Payments Reporting System (TPRS) currently applies to the building and construction sector to enable data-matching and facilitate the ATO's compliance oversight. Further to the government's commitment to address the black economy, the TPRS regime will be extended to contractors in the courier and cleaning industries from 1 July 2018. Businesses in these sectors will need to consider their compliance processes to ensure they are prepared for first reporting in August 2019. This is part of a broader review of the Black Economy.

Key insights

- The expansion of the non-resident CGT regime, to require the principal asset test to be assessed on an associate-inclusive basis, will present practical complexities to those multinational groups that are either disposing of or restructuring their Australian investments.
- Given the requirement that affordable housing MITs must generate more than 80% of their income from affordable housing (which is by definition earning below market rental income), the proportion of affordable housing within the MIT may need to be materially higher than 80%. As such, this may limit the expansion of eligible investment activities into residential housing, to MITs that almost entirely comprise affordable housing investments.
- The MAAL integrity and OECD hybrid mismatch changes are relatively narrow in their application and it will be a welcome relief to many business that these changes should not apply to them and that the government has not materially expanded the scope of these measures.



Banking

Bank Levy

Payable at an annual rate of 0.06% on a bank's liabilities, the levy will target wholesale and interbank activity by excluding from the tax base deposits of less than \$250,000 by individuals and other entities that are protected by the Financial Claims Scheme.

The ability of the major banks to indirectly pass the cost of the levy onto retail customers will be restricted by an ACCC residential mortgage pricing inquiry to take place through 30 June 2018, requiring the affected banks to explain changes in interest rates, fees and charges over this period.

Applicable only to the major banks with liabilities of more than \$100 billion, the government has explicitly noted the impact the levy will have on levelling the playing field for the smaller banks and credit unions and promoting competition.

Coleman Report

The government has agreed or agreed in principle with all but one of the recommendations in the Coleman Report (Review of the Four Major Banks) aimed at improving competition and regulation in the banking sector. The measures include:

- the creation of the Australian Financial Complaints Authority to replace the various existing dispute resolution bodies and to act as a one-stop shop for retail clients
- the relaxation of the 15% ownership cap for substantial shareholders in ADIs
- a Banking Executive Accountability Regime.



Julian Humphrey
Partner, Corporate Tax

"The anticipated measures designed to strengthen oversight of the banking sector and promote greater competition have been overshadowed by the announcement of a levy on the non-retail liabilities of the major banks."

Banking Executive Accountability Regime

The government's proposed accountability regime will have the following consequences for ADIs and their executives:

- an ADI must meet mandatory standards of integrity, diligence and prudence in running its business, or face a civil penalty of up to \$200 million
- an ADI must advise APRA of all prospective senior executive appointments, and those executives must register with APRA
- APRA may deregister an executive who has not met APRA's expectations as to their business conduct, meaning the executive can no longer work in that role
- there will be mandatory deferral, for a minimum of 4 years, of at least 40% of an ADI executive's variable remuneration (60% for the CEO).

In addition, APRA will acquire stronger powers to remove and disqualify senior executives and directors.

Anti-Hybrid Measures

The OECD hybrid mismatch rules will apply to bank's regulatory capital. Additional Tier 1 capital (AT1) will not be frankable where returns are deductible in another jurisdiction. Where the funds are not wholly used in the offshore operations, the franking account of the issuer will be debited as if the returns were franked.

Arrangements issued before Budget Night will be grandfathered up to their first call date (typically 5 years from the issue date). Otherwise, the measure will apply to returns paid on or after the later of 1 January 2018 or 6 months after Royal Assent, which aligns the start date with the broader hybrid mismatch rules.

Key insights

- The strength of these measures serve the dual purpose of addressing what the government sees as community concerns regarding the conduct of the major banks while at the same time muting the opposition's calls for a banking Royal Commission.
- Remuneration committees will need to reassess the appropriate balance between fixed pay and short and long-term incentives, in light of the proposed mandatory deferral regime.
- In a blow to the banks, the government has not aligned Australia's tax treatment of AT1 with most other major jurisdictions which treat AT1 as deductible for tax purposes, which would have enhanced financial system stability by enabling banks to diversify their funding sources away from the domestic retail market.



The black economy

The Black Economy Taskforce's (the Taskforce) interim report has been released as part of the Federal Budget for public comment and consultation. The report estimates the cash economy to be around 1.5% of our gross domestic product, or \$25 billion. The black economy results in reduced income and consumption tax revenues (estimated at \$10 billion), as well as higher welfare payments (estimated at \$4 billion) due to the understatement of income.

The government will proceed with a small number of interim recommendations immediately. The Taskforce will deliver a final report in October 2017 that will include an overarching whole of government policy framework and detailed proposals for action to counter the black economy.

What is the 'Black Economy'?

The black economy refers to people who operate entirely outside the tax system or who are known to tax authorities but deliberately misreport their tax obligations. The black economy can also include those engaged in organised crime, including those who engage in the production and sale of prohibited goods.

The Taskforce has found cash economy activity is widespread in labour-hire companies (e.g. cleaning, fruit picking, abattoirs), cafes and restaurants, hair and beauty, building and construction, and child care services.

The Black Economy is comprised of innocent parties who want to comply but are stifled by complex regulation, as well as outright tax evaders.

Why is it a problem?

The economic and social implications include a reduced tax base, an unlevel playing field for cash versus non-cash participants, and worker exploitation (e.g. pay is below the minimum wage and non-payment of employer obligations). Furthermore, the cash economy undermines confidence in the fairness and equity of the system, and can impact community attitudes to tax compliance more generally.



Geoffrey Yiu

Partner, Tax

"Reforms to address the Black Economy will help level the playing field for SMEs and protect vulnerable employees, as well as contribute to a wider process of cultural change."

Initial recommendations being early adopted

- Extension of the Taxable Payment Reporting System that currently applies in the building and construction industry to contractors in the courier and cleaning sectors from 1 July 2018
- Ban on the manufacture, distribution, possession, use or sale of sales suppression technology (which can untraceably delete transactions from electronic records), with effect from the day of Royal Assent of the enabling legislation
- One year of additional funding (\$32 million) for ATO audit and compliance programs to 30 June 2018.

Key initial recommendations being considered further

- Australian Government contracts to be limited to firms with a good tax record and who are not engaged in bribery or corruption
- Tax and other incentives for small businesses who adopt a non-cash business model
- No deduction for cash wage payments, unless all reporting and withholding obligations have been met, such as issuing payment summaries
- Rationalise business registries and strengthen business registration and verification arrangements
- Greater cooperation between federal, state, territory and local governments
- Tax literacy modules to be included in vocational education training, small business courses and in new migrant communities.

Policy options for consultation (non-exhaustive)

- An economy wide cash payment limit (e.g. \$10,000)
- A sharing economy reporting regime
- Lowering the goods and services tax threshold
- Additional withholding obligations.

Key insights

- Courier and cleaning businesses will need to ensure they have the systems to start collecting information from 1 July 2018 for first reporting in August 2019.
- Tenderers for significant government contracts may need to ensure they can demonstrate a good tax compliance history, and that they are not engaged in bribery or corruption.
- Opportunities should open up for businesses where their competitors are impacted by the black economy reforms.
- Submissions to the Taskforce close on 30 June 2017.



Small business

Tax rates

The Budget did not alter the previously announced changes to the tax rate for small businesses, which are reproduced below and currently await Royal Assent.

Year	Aggregated Annual Turnover Threshold	Tax Rate
2015-16	\$2 million	28.5%
2016-17	\$10 million	27.5%
2017-18	\$25 million	27.5%
2018-19	\$50 million	27.5%
2019-20 to 2023-24	\$50 million	27.5%
2024-25	\$50 million	27.0%
2025-26	\$50 million	26.0%
2026-27	\$50 million	25.0%

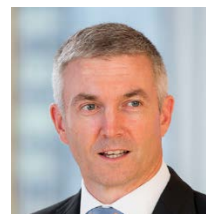
Key issues for qualifying for the lower rates will be:

- 1) whether the company is carrying on a business
- 2) the measurement of the turnover threshold and, in particular, the inclusion of the turnover of 'connected entities'.

In addition, it is not always clear whether certain investment-type companies are carrying on a business. ATO guidance on the matter would therefore be welcome.

Small business tax measures

The \$20,000 small business asset write-off applicable to businesses with aggregated turnover of less than \$10 million has been extended to 30 June 2018. From 1 July 2018 the immediate deductibility threshold will revert back to \$1,000.



Simon Thorp

Partner, Enterprise

"Previously announced changes to tax rates and the extension of the small business asset write-off are positive initiatives for small business. However, care needs to be taken as there is some complexity in their application."

From 1 July 2017 the small business capital gains tax concession applicable to businesses with aggregated turnover of less than \$2 million, or business assets less than \$6 million, will be tightened so that it only applies in relation to assets used in a small business or ownership interests in a small business.

Franking credits

The changes in the company tax rate also mean changes to the franking credits that can be attached to a dividend. Under existing rules, even if a company qualified for the lower small business tax rate of 28.5% for the 2015-16 year, a dividend could still be franked at 30%. The result would mean that a company's franking account balance would reduce at a faster rate in comparison to the tax they paid.

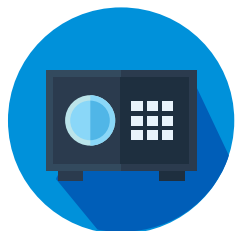
Under the new measures, a company will allocate franking credits to dividend distributions using the corporate tax rate applicable for the current year. However, this rate will be based on the company's aggregated turnover in the prior year. Where the prior year turnover is equal to or exceeds the turnover threshold for the current income year, franking credits will be allocated to distributions at 30% (irrespective of the current year aggregated turnover). What this means is the rate used to determine the franking credits attaching to a franked dividend could be different to the actual corporate tax rate for that year.

Example

Year	Aggregated Turnover	Threshold	Tax Rate	Franking Credit Rate
2015-16	\$11 million	\$2 million	30%	30%
2016-17	\$9 million	\$10 million	27.5%	30%
2017-18	\$13 million	\$25 million	27.5%	27.5%

Key insights

- Businesses potentially impacted by tax rate changes should closely examine turnover thresholds which take into account the turnover of connected entities.
- Dividend payment strategies should be re-examined in light of the change in tax rates particularly if aggregated turnover is in the \$10 million range.
- Capital expenditure plans should be reviewed given the one year extension to 30 June 2018 of the \$20,000 small business asset write-off.
- Those seeking to use small business capital gains tax concessions should revisit asset qualification in light of the tightening of integrity measures.



Superannuation



Dana Fleming

National Leader,
Superannuation Tax

“Extending the tax relief for merging superannuation funds will be welcomed by the industry. We would have liked this provision to be a permanent provision within the Act.”

What is new in the Budget?

Topic	Budget measure
Extending tax relief for merging superannuation funds	Current tax relief was due to expire on 1 July 2017 - extended to 1 July 2020.
Housing affordability measures – contributing the proceeds of downsizing to superannuation	Non-concessional contributions up to \$300,000 per individual from selling a principal residence held for 10 years or more. Not subject to non-concessional contributions cap. Applies from 1 July 2018.
Housing affordability – First Home Super Saver Scheme (FHSSS)	Concessional contributions (i.e. taxable in the fund at 15%) of up to \$15,000 per year and \$30,000 in total. Able to be withdrawn for a first home deposit from 1 July 2018 – subject to tax with tax offset on withdrawal.
Integrity measure – limited recourse borrowing arrangement (LRBA)	Integrity measure aimed at the use of LRBA to circumvent the \$1.6 million transfer balance cap rules – aimed at SMSFs and small APRA funds.
Integrity measure – non arm’s length arrangements	Integrity measure for non-arm’s length arrangements to ensure appropriate expenses are recognised in the fund.

Key insights

Extending tax relief for merging superannuation funds

- The government’s key policy settings for the superannuation industry require funds to continue to consider scale and efficiency so as to increase value for members. The present scheduled expiry of capital gains tax rollover relief for fund mergers occurring on or after 2 July 2017 is inconsistent with these settings.
- The relief enables the closing fund in a merger to transfer its unrealised tax positions to the ongoing fund along with the relevant assets. This means that the government continues to collect the tax in the usual timeframe (i.e. when the relevant asset is then sold in the ordinary course). Without the relief, these unrealised tax positions are crystallised at the date of merger. The associated time value of money cost results in an effective cost to the members of the closing fund.

Contributing the proceeds of downsizing to superannuation

- The impact on housing affordability of contributing the proceeds of downsizing to superannuation will be interesting.
- This measure will be attractive to a group of members who would like to sell their family home but due to contribution caps would have been prevented from topping up their superannuation balance essentially transferring funds from one tax preferred asset to another.

Recap on previously enacted changes – From 1 July 2017

Growing your super	Accessing your super
Annual concessional contribution cap reduced to \$25,000	Transition to retirement income streams (TRIS) - Earnings taxed at 15%
Annual non-concessional cap reduced to \$100,000. Three year bring forward of the cap for members under 65 with balances below \$1.6 million	\$1.6 million maximum balance for a member when they transition from accumulation to pension phase
Concessional contributions - 5 year rolling catch-up for members with balances under \$500,000 (from 1 July 2018)	Defined benefit income streams with commutation restrictions – removal of concessional tax status for income in excess of \$100,000
Deductible contributions allowed for individuals under 65, and those aged 65 to 74 who meet the work test	Anti-detriment provisions abolished for members that pass away from 1 July 2017 (all death benefits from 1 July 2019)
Low income superannuation tax offset - Broadly equivalent in effect to the Low Income Superannuation Contribution	Removal of barriers to the innovation in retirement income stream products
Division 293 tax – Threshold for additional 15% tax on concessional contributions reduced to \$250,000	



Infrastructure

Overview

Infrastructure is a key focus of the Budget with a series of announcements to stimulate investment and deliver \$75 billion in funding and financing over a 10 year period.

Key announcements

The government has committed to progressing the Western Sydney City Deal by investing up to \$5.3 billion of equity in WSA Co to build Western Sydney Airport, with works to commence in late 2018. While the budget also makes tangential references to further City Deal measures, it falls short of committing to specific deals, with the exception of a South East Queensland Deal.

In addition to the WSA commitment, the government will provide an equity investment of \$8.4 billion in the Australian Rail Track Corporation over 7 years to deliver the Melbourne to Brisbane Inland Rail project. Structuring its investments in this manner, and not traditional grant funding, appears to be a key driver in the government achieving an 'off budget' position.

In the Energy sector, discussions are underway to increase the Commonwealth's ownership in the Snowy Hydro Scheme – with funds received by the states to be reinvested in priority infrastructure projects.

The government reconfirms its commitment to funding rail infrastructure with the establishment of a transformational \$10 billion National Rail Program to improve connections between cities and regions.

An additional measure is the \$472 million Regional Growth Fund for investment in infrastructure projects to grow regional productivity.

An Infrastructure and Project Financing Agency (IPFA) will be established as an advisory body within the Department of Prime Minister & Cabinet to assess and develop innovative financing solutions for major infrastructure projects. A central issue that will need to be resolved is how major investments will be funded (repaid) and we welcome initiatives from IPFA to address this challenge.



Paul Foxlee

National Sector Leader, Transport & Infrastructure

"The government's commitment to investing in productive infrastructure is an encouraging sign that it is serious about driving national growth and generating real productivity benefits."

Capital investments

The government's project announcements primarily focus on road and rail packages, utilising a combination of new and previously allocated funding. Key project announcements include:

- \$844 million towards new sections of Queensland's Bruce Highway upgrade.
- \$1 billion for new and upgraded rail infrastructure in Victoria, utilising funding previously allocated to the Asset Recycling Initiative.
- \$792 million allocated towards Perth's Metronet (redirected from the Perth Freight Link).

Funding for the development of business cases to deliver high speed rail between cities and regions is a further signal of the government's commitment to future transport investments.

Announced infrastructure project funding	
Project	Value \$b
New South Wales	
Western Sydney Infrastructure Plan	2.9
Pacific Highway	5.6
WestConnex	1.5
Sydney Metro	1.7
Victoria	
Monash Freeway upgrade	0.5
Queensland	
Bruce Highway	6.7
Western Australia	
Metronet (reallocated)	0.8
South Australia	
North-South Corridor (various)	1.2
Multi state	
Northern Australia Roads Programme	0.6

Key insights

- The Federal Government's commitment to productive infrastructure spending is welcome but also heightens the need for tighter project selection processes, including the full assessment of options and economic benefits.
- The focus on regional development, together with commitments to a pipeline of transport projects (subject to business case assessments), will drive productivity across the nation. The use of grants, debt and equity will enable projects, including Inland Rail and Western Sydney Airport, to progress and we look forward to commercial insights from the IPFA on the mechanics for securing returns on such investments.



GST

GST on new property transactions to be collected by purchasers

The last two Budgets have contained tax integrity measures to impose GST on foreign entities who provide digital supplies and services (referred to as the 'Netflix tax') and low value goods to Australian consumers. On Budget night, the Economics Legislation Committee announced its recommendation that the 2016 Budget initiative to impose GST on low value imported goods be delayed 12 months to 1 July 2018.

This Budget continues the theme of tax integrity measures by requiring that, from 1 July 2018, purchasers of new residential premises remit the GST amount directly to the ATO as part of the settlement process. This announcement comes as a surprise and is a significant divergence from the way the GST system currently operates whereby purchasers pay the GST amount to the supplier as part of the total purchase price and the supplier is required to remit the GST to the ATO.

KPMG recalls that around 4 years ago, ATO compliance programs targeted illegal phoenix activity purportedly from a number of property developers who repeatedly placed companies in liquidation with outstanding GST obligations, despite having claimed input tax credits on construction costs. However, KPMG is not aware of recent industry consultation on the issue of developers failing to remit GST on sales of newly constructed residential properties. In the absence of such consultation, we question the practicality and administrative cost of imposing GST on unregistered 'mum and dad' purchasers. Where developers use the margin scheme to calculate the GST liability, the purchaser is unlikely to be aware of the amount of GST included in the purchase price.

This measure will therefore require developers to change the way they disclose the price of newly constructed residential properties to ensure the GST liability is disclosed as a separate line item to enable the purchaser to remit the appropriate amount of GST. Those involved in the settlement process (e.g. financiers, lawyers and conveyancers) will also need to be mindful of their obligations in terms of ensuring that purchasers meet their obligations. What is not clear from the Budget papers is what penalties or avenues of recourse are available for the ATO in the scenario that a purchaser fails to meet its obligation to remit the GST amount to the ATO (whether inadvertently or deliberately).

The Budget papers state that this measure is estimated to increase GST revenue by \$660 million and associated payments to the states and territories, net of



Kate Law

Partner, Tax

"This Budget continues the theme of tax integrity measures by requiring, that from 1 July 2018, purchasers of new residential premises remit the GST directly to the ATO as part of the settlement process."

administrative costs, by \$1.6 billion over the forward estimates period (4 years to 2020-21). However, the Budget papers state that the difference is due to the timing of when GST is collected and recognised. This suggests that it is not a permanent GST difference, which is seemingly at odds with the government's statement that some developers are failing to remit the GST to the ATO.

Combatting fraud in the precious metals industry

In another integrity measure, legislation will be introduced to give effect to previously announced changes to combat GST fraud in the precious metals industry.

Similar to the integrity measures in relation to the sale of new residential properties, these changes require a buyer of gold, silver and platinum to remit the GST to the ATO instead of the seller.

Changes are also made to clarify that gold, silver and platinum are not second-hand goods, to ensure that GST registered entities do not incorrectly claim input tax credits when acquiring gold, silver or platinum, regardless of its form. These changes to the GST law are said to target criminal activity and not genuine participants in the second-hand jewellery and collectibles market.

This measure is estimated to have an unquantifiable gain to GST tax revenue as it ensures the GST payable is collected as intended and does not affect the amount of GST payable.

Treatment of digital currency aligned with money

In a welcome measure that follows significant consultation and discussion with industry groups, the government will align the GST treatment of digital currency (such as Bitcoin) with money from 1 July 2017 to ensure it is no longer subject to GST.

This will eliminate double taxation in circumstances where GST applied to the purchase and trade of the digital currency.

This measure is estimated to have a small but unquantifiable decrease in GST collections and is said by the government to remove an obstacle for the Financial Technology (Fintech) sector to grow in Australia.



Health and Aged Care

Health accounts for more than \$1 of every \$6 of government expenditure in the Budget. The bulk of that health expenditure is in four areas:

- Medicare benefits – \$23 billion (30.4%)
- public hospital funding through states and territories – \$19.6 billion (26.0%)
- pharmaceutical benefits – \$12.4 billion (16.5%)
- support for private health insurance – \$6.4 billion (8.5%).

In recent Budgets, the government has focused on measures to reduce the growth of health expenditure. This Budget again has significant expenditure reduction measures but complements these with new investments in healthcare and new revenue raising initiatives. These are principally in primary medical care and in pharmaceutical benefits.

Medicare Guarantee Fund and Health Compacts

The government has announced the establishment of the Medicare Guarantee Fund (the Fund), to meet the growing costs of Medicare and the Pharmaceutical Benefits Scheme (the PBS). This commitment is likely to counter the perception that the government does not support Medicare.

The Fund is expected to cover the \$143 billion cost of Medicare and PBS over the 4 years of the forward estimates. It will be funded through a combination of Medicare Levy receipts and personal income tax receipts. The government's ability to deliver on the Fund will depend on the new tax measures passing through parliament. The linking of these measures to funding Medicare, the National Disability Insurance Scheme and PBS makes this likely to succeed.

The government has extended the Medicare Levy from 2% to 2.5%.

Underpinning the health budget was the government's establishment of new 'health compacts' with five key stakeholders which outline shared principles relating to transparency in decision-making, accountability for reforms, stability and certainty in regard to government investment. These compacts set the foundation for long-term engagement and cooperation with stakeholders – including the AMA and the Pharmacy Guild – to increase the pace of reform across Australia's health system.



Liz Forsyth

National Sector Leader,
Health, Ageing & Human Services

"The government has clearly set out its position with regard to Medicare and the Pharmaceutical Benefits Scheme by establishing the Medicare Guarantee Fund and restoring MBS indexation over time. Underpinning the health budget was the government's establishment of new 'health compacts', which set a strong foundation to increase cooperation and the pace of reform across Australia's health system."

Removing the Medicare freeze

The 2016–17 Budget extended the freeze on indexation of the Medicare rebate through to June 2020. The Budget takes a phased approach to restoring indexation of the Medicare rebate, commencing from 1 July 2017 with an initial addition of \$9.5 million to health expenditure in 2017–18, growing to a total of \$1 billion over the forward estimates. Starting with GP bulk billing incentives, the changes will be implemented in phases until 2020 with the indexation of standard GP and specialist consultations resuming on 1 July 2018.

Prescription drugs

The prescription drug market has undergone several measures in an effort to curtail the \$12.4 billion expenditure burden of the PBS. With a drug budget that is facing ongoing growth as the population ages, pressures through increased prevalence of chronic illness, as well as new and innovative drugs awaiting reimbursement, the government has announced further reforms.

The Budget includes several measures aimed at saving \$1.8 billion on the PBS over 5 years through implementing changes geared towards reducing prices and increasing the use of generic medicines. The commitment is that \$1.2 billion in savings will be returned to the PBS budget, to fund new and innovative drugs that will lead to better health outcomes. The government has committed to greater access to medicines in landmark agreements with Medicines Australia and Generic and Biosimilar Medicines Association.

Aged care

Following significant funding reductions in previous budgets, the ageing sector has been largely overlooked in this year's Budget.

The government has announced some minor initiatives, including a \$3.1 million investment in support of the My Aged Care platform and \$67.3 million to modernise the health and aged care payments system. These investments should assist providers in their operations, including supporting the development of more timely and reliable payments from the Department of Human Services to support organisational sustainability.

Whilst not directly impacting the aged care sector, the announcement of the incentives to retired Australians who are willing to downsize are designed to have a positive impact on housing affordability. When downsizing, seniors will be eligible to make a non-concessional superannuation contribution of up to \$300,000 without being subject to existing contribution caps. This is

designed to support the transition of elderly into more age appropriate dwellings. However, it has the potential to increase the number of consumers who will be required to make a co-contribution for home care and/or contribute more to residential aged care, which may still remain a disincentive for older Australians to downsize

Key insights

- The government's new Medicare Guarantee Fund will quarantine a component of the increased Medicare Levy to meet the growing costs of the MBS and PBS.
- The government has announced a phased approach to restoring the Medicare rebate indexation as a means to neutralise the perception that it does not support Medicare.
- 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 sector are minimal and it is unfortunate that the opportunity for more substantive reforms has not been seized.





Human services

Human Services is dominated in expenditure terms by Social Security and Welfare spending. Social Security and Welfare account for more than a third (35.3%) of total government expenditure. Most of this is related to welfare payments for three groups:

- assistance for the aged, veterans and their dependants – \$70.6 billion (43.0%)
- assistance for people with a disability – \$38.5 billion (23.5%)
- assistance for families with children – \$36.9 billion (22.5%).

Human services expenditure in the Budget has grown by 5.4% over the previous year's expenditure, with growth projected to continue.

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.

The Budget announced \$84.1 million over 5 years from 2016-17 to consolidate seven working age payments and allowances into a new JobSeeker Payment. While these measures are a welcome contribution to simplification, they relate in large part to already closed payments, and the opportunity for more significant reform to balance fairness and sustainability has been missed.

The Budget dispenses with \$13 billion of savings that the government could not pass through the Senate. These measures are replaced by a range of alternative savings most significantly from Family Payments including:

- \$1.9 billion over 4 years from 2017-18 by not increasing the maximum rate of Family Tax Benefit (FTB) Part A as previously announced
- \$2 billion over 5 years by pausing indexation on FTB payment rates for 2 years from 1 July 2017
- \$415.4 million over 5 years by changing the income test taper for the Higher Income Free Area.

Other savings measures include:

- \$119.1 million over 5 years by revising the residency requirements for claimants of the Age Pension and the Disability Support Pension (DSP)
- \$94.7 million over 5 years by tightening eligibility for the Pensioner Education Supplement



Ben Wallace

Director, Health Aged Care & Human Services

- \$181.2 million by limiting students undertaking courses approved for VET Student Loans
- \$138.5 million over 4 years by extending the Liquid Assets Waiting Period from 13 weeks to 26 weeks.

Newstart

It is broadly recognised that Newstart payment is inadequate. The Business Council of Australia suggests the low level of Newstart forms a barrier to employment. It is disappointing that the government has not made changes to the Newstart base rate, a matter which remains to be corrected.

The budget also announces significant new measures regarding mutual obligation requirements designed to save \$632m over 5 years. While payment integrity is critical to the sustainability of the welfare system, proposed measures to link drug testing and income support eligibility may be counter-productive. People experiencing drug dependence require access to appropriate support and services to help address their addiction. Should these measures proceed it is critical that support services are made available.

Income Management

The government has funded an expansion of the Cashless Debit Card Trial, which has been running in Ceduna and the East Kimberley. Funding allows continuation of these trials and expansion to two new sites. The budget also announces \$145.5 million over 3 years to extend income management in all current sites with services provided renamed Money Support Hubs.

National Disability Insurance Scheme

The NDIS will provide care and support tailored to individual circumstances for over 460,000 eligible people with a significant and permanent disability.

The Budget introduces an increase in the Medicare Levy from 2% to 2.5% from 1 July 2019 netting \$8.2 billion over 4 years to contribute to the unfunded future costs of the NDIS.

Following extended negotiations with Western Australia (WA) the Commonwealth will provide \$868.2 million over 3 years from 2017-18 to support the delivery of the WA NDIS but under a locally administered model.

The government will also provide \$209 million over 4 years from 2017-18 to establish a new, national, independent regulatory body, the NDIS Quality and Safeguards Commission.

A New National Housing and Homelessness Agreement (NHHA)

After an extended period of uncertainty about future funding arrangements, the Commonwealth has committed additional funding to enter into a new agreement with states and territories. From 2018-19 the NHHA will combine funding currently provisioned under the National Affordable Housing Specific Purpose

Payment and the National Partnership Agreement on Homelessness. The government will provide an additional \$375.3 million over 3 years from 2018-19 to fund ongoing homelessness support services, with funding to be matched by the state and territory governments.

Parent Employment Programs

Aiming to increase employment participation rates of parents, particularly those with school aged children the Budget has expanded the ParentsNext program at a cost of \$263 million over 4 years from 2017-18 requiring Participation Plans and engagement in activities that will help prepare them for employment with intensive support to be available in areas with higher numbers of Indigenous parents.

Domestic and Family Violence

Domestic and family violence has received significant and warranted attention in recent times.

Building on previous measures, this budget provides a further \$39 million over the next 3 years for family law and family violence services delivered through Community Legal Centres.

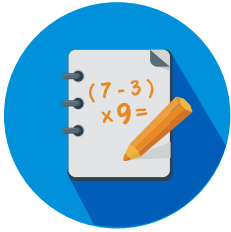
These supports draw on the recommendations of the Third Action Plan under the National Plan to Reduce Violence Against Women and their Children.

Social Impact Investing

The Budget has announced two small but welcome measures to support social impact investing:

- \$10.2 million over 10 years from 2017-18 to partner with state and territory governments to trial Social Impact Investments aimed at improving housing and welfare outcomes for young people at risk of homelessness.
- \$20.2 million over 10 years from 2017-18 to encourage the development of the Australian market for social impact investments.





Education

After two quiet years for education, it is back in the Budget spotlight. Schools will receive an extra \$18.6 billion by 2027 under 'Gonski 2.0', \$22.3 billion less than Labor had negotiated with states and territories. Only \$1.7 billion is within the forward estimates period. Higher education, however, will contribute \$2.8 billion towards budget repair instead of the \$4.2 billion expected from the blocked 2014 proposals.

In more detail, David Gonski AC will chair a further review to advise the Commonwealth Government on how to distribute the schools funding, with the goal of educational excellence and arresting the slide of students' performance in international testing. It seems that 51 non-government schools will receive less Commonwealth Government funding, and at least 250 will receive a smaller increase than expected in what the Treasurer describes in his Budget Speech as a "fairer and simpler way to meet our shared commitment to educate each and every child."

In higher education, the 2014 proposals to deregulate domestic student fees and cut Commonwealth Government teaching grants by approximately 20% have been abandoned, as "Unlegislated Budget Repair Measures - not proceeding".

Instead, an efficiency dividend of 2.5% will be applied to the Commonwealth Grants Scheme (CGS) in each of the next two financial years, and student fees will increase progressively, cumulating to 7.5% after 4 years.

In addition, the income threshold for HELP debts is lowered to \$42,000 and the repayment rates increased.

From 1 January 2018, the Federal Government will introduce a performance-based element to the CGS worth 7.5% of total CGS cluster funding, resulting in a pool of around \$500 million. During 2017-18, the Federal Government will be working with the higher education sector to develop appropriate metrics to meet performance requirements for these funds.



Stephen Parker, AO

National Sector Leader, Education

"After two quiet years for education, it is back in the Budget spotlight."

Vocational education and training does not feature in this Budget as such but a new Skilling Australians Fund of \$1.5 billion over 4 years is created, funded by a levy on businesses that employ foreign workers on certain skilled visas. When matched with funding from the States, this supports 300,000 apprenticeships and traineeships.

Sector	Spend \$ billion	Comment
Schools	\$1.7 over 4 years from 2017-18	\$18.6 billion to 2027
Universities	-\$2.7 over 5 years from 2016-17	Efficiency dividend built into base from 2020
Skills	\$1.5 over 4 years from 2017-18	Funded by business levy. States must match.

Key insights

- Students' average contribution to their university costs is rising in stages from 42% to 46%.
- The 'Gonski 2.0' schools proposals face an uncertain future.
- From a policy point of view, the measures in the Budget may pass up the opportunity to design an integrated tertiary system geared to the future world of work.



Defence

This Federal Budget re-confirmed the commitment made in the 2016 Defence White Paper to increase defence expenditure to 2% of GDP by 2020-21 – 3 years ahead of the original timetable.

Having invested \$28.4 billion into defence in 2016-17, the Federal Government plans to spend \$30.1 billion in 2017-18, a 3.5% increase in real terms. This is forecast to increase further in 2020-21 when it reaches \$33.9 billion, a further 5.3% increase.

However, it is the internal cash distribution that will intrigue defence businesses. The impact of the government's \$200 billion re-capitalisation of Australian Defence Force (ADF) assets is now material – as the proportion of budget earmarked for capital investment versus operations and people rises markedly from 21% in 2016-17 to an expected 30% in 2019-20.

Confirmed projects	Total Defence Expenses	Est. Defence Capital Spend %
2016-17	\$28.5 billion	21%
2017-18	\$30.1 billion	27%
2018-19	\$29.9 billion	30%
2019-20	\$31.7 billion	30%
2020-21	\$33.9 billion	*

*Data not available to calculate the percentage.

While this internal switch to capital is largely funded through top line budget increases, there are also efficiency measure announcements. The \$300 million reduction to consultancy and contractor spending over 4 years will be noticed in Canberra, however, increases of 620 defence public servants and 470 military personnel in 2017-18 will offset these savings.

The Budget again highlights a number of already announced projects in the naval shipbuilding sector totalling nearly \$90 billion. Compared to air, land and joint program spending, this maritime investment continues to consume the largest share of the \$200 billion assigned to new defence capability through to 2025-26.



Mike Kalms

National Sector Leader, Defence Industry

"This is a solid budget for the Australian defence industry, particularly the big end of town. Canberra's consultancy spend will be pruned."



Sally Calder

Partner, People and Change

"The 2016 Defence White Paper capital spend is clearly ramping up. Can industry and Defence collaborate to implement the required change?"

The cost of operations continues to drive supplementation of the defence budget – in 2017-18 this is expected to consume \$817 million of the increase. Its absence in the 2018-19 forecast creates an incorrect impression of decline.

The break up of Australian Submarine Corporation (ASC)

Project SEA 1000 will see \$50 billion invested over 40 years in 12 new submarines, designed with DCNS of France. To enable construction, the government has commenced the

re-organisation of ASC, announcing the establishment of Australian Naval Infrastructure Pty Ltd in the Budget. Separating the submarine build and sustainment assets from the operational parts of ASC is an important step towards preparing the sector for continuous shipbuild.

Preparing the defence industry for this wave of investment remains a priority for the Federal Government, largely implemented and funded through the Centre for Defence Industry Capability at \$23 million per annum.

\$8 billion over 4 years from 2017-18 for new defence infrastructure will be welcomed by regional Australia where the bulk of this investment will land; in locations such as Newcastle's Williamstown and South Australia's Cultana training area.

On balance, there are no real surprises in this 2017 Federal Budget for defence. The roadmap outlined in the 2016 Defence White Paper continues to be followed, and the proportion of the \$200 billion capital investment heading towards Australian business is rising.

Key insights

- A good budget for the defence industry as the roadmap described in the 2016 Defence White Paper continues to be followed.
- Having invested \$28.4 billion in defence in 2016-17, the government plans to spend \$30.1 billion in 2017-18, a 3.5% increase.
- Compared to several western nations, Australia continues to stand behind its commitment to 2% of GDP and the capital injections required to ensure the Australian Defence Force has the modern equipment needed.
- A \$300 million reduction to consultancy and contractor spending over 4 years will be noticed within Canberra. Increases of 620 defence public servants and 470 military personnel in 2017-18 will offset these savings.

Overview of changes

The main contributors to the changes in Revenue and Expenditure for 2017–21 as outlined in the Budget papers.

Top 10 Revenue contributors/expenditure savings		Top 10 Revenue reductions/expenditure increases	
2017–21	\$ billion	2017–21	\$ billion
Personal income tax — increase in the Medicare levy — National Disability Insurance Scheme	8.2	Unlegislated Budget Repair Measures — not proceeding	(14.7)
Major bank levy — introduction	6.2	Quality Schools — true needs-based funding for Australia's schools	(1.8)
Higher Education Reform — a more sustainable higher education sector	3.8	Skilling Australians Fund	(1.5)
Funding the Jobs for Families Package	2.0	Improving Access to Medicines — Pharmaceutical Benefits Scheme — new and amended listings	(1.2)
Family Tax Benefit Part A rate increase — not proceeding	1.9	Guaranteeing Medicare — Medicare Benefits Schedule — indexation	(1.0)
Infrastructure Investment Programme — offsets	1.6	Tax Integrity Package — improving the integrity of GST on property transactions	(0.9)
Improving Access to Medicines — cheaper medicines	1.3	Extending the immediate deductibility threshold for small businesses	(0.7)
Skilling Australians Fund levy — introduction	1.2	Infrastructure Investment Programme — National Rail Program	(0.6)
National Disability Insurance Scheme — finalisation of transition arrangements	0.8	Support for Health Services in Tasmania	(0.5)
Better Targeting of Assistance to Support Jobseekers	0.6	Regional Growth Fund	(0.5)

Announced but unenacted measures

The tables below summarise a number of announced but unenacted tax measures, as well as other outstanding tax related developments.

Measures before Parliament	Measures not yet introduced/decided
1 Enterprise Tax Plan – plus large business company tax cuts to be reintroduced	1 Stapled Structures policy options
2 Losses – similar business test	2 Petroleum Resource Rent Tax (PRRT) revisions
3 Intangible assets – self-assessing effective lives	3 Visa changes – Temporary Skill Shortage visa
4 GST – low value imported goods	4 Superannuation – finalising 2016-17 new measures
5 Superannuation – objectives of the superannuation system	5 Foreign Investment Framework changes
6 Working Holiday Maker Reform – tax rates and employer register	6 Debt and equity integrity rules
	7 Tax consolidation amendments – e.g. deductible liabilities
	8 Transparency measures – Mandatory Disclosure Regime, Register of Beneficial Ownership of Companies, Whistleblower Framework
	9 Research and Development incentives – government response to recent review

ATO administrative developments
1 International tax – Diverted Profits Tax guidance, marketing hubs, related party debt guidance post Chevron case, Country-by-Country reporting
2 Significant Global Entities and general purpose financial statements plus new penalties
3 Infrastructure privatisation
4 PRRT guidance
5 Company residency test
6 Superannuation new measures guidance
7 Early stage investor tax incentives guidance

CFO / Head of Tax checklist

Detail	checklist
1 Employment Taxes • Adjust payroll systems to reflect increased Medicare levy rates • Adjust reporting/accounting systems to reflect consequential impact, e.g. on FBT rates • Adjust payroll systems to reflect increased Medicare levy low-income thresholds	☐
2 MAAL Integrity Measures • Confirm whether any arrangements involving foreign trusts or partnerships have been entered into that could be subject to MAAL	☐
3 Hybrid Mismatch Rules • For banks/financial institutions, consider proposed extension of rules to cover Additional Tier 1 regulatory capital • For other groups, prepare for introduction of anti-hybrid rules	☐
4 Transactions With Non-Residents • Consider obligations under foreign-resident withholding regime on disposals of real property to foreign residents • Ensure legal agreements are appropriately drafted to allow for withholding and/or provision of clearance certificate	☐
5 Foreign Investors • For inbound groups, consider the impact of the inclusion of associates to the principal asset test element of non-resident CGT exemption when modelling capital gains on disposals of interests in Australia • For groups seeking foreign investors, consider whether impact of changes to foreign investment framework make attracting foreign investors less onerous	☐
6 Small Business • Consider planned capital expenditure in light of extension to 'immediate deductibility' regime • Consider whether proposed integrity measures impact availability of CGT concessions	☐
7 MITs • Consider possible investment in qualifying 'affordable housing' projects and/or potential flow-through of increased CGT discount to qualifying investors	☐
8 Banks/Financial Institutions • Consider impact of Bank Levy • Entities not directly subject to Bank Levy to consider whether imposition of levy may indirectly impact cost of finance from banks that are directly impacted	☐
9 Immigration Reform • Consider impact of changes to Australia's visa arrangements for skilled workers • Consider communication to any existing/potential employees impacted	☐
10 Black Economy • Monitor potential changes to reporting requirements generally • For cleaning and courier sectors: consider new reporting obligations under Taxable Payments Reporting System • Consider how to demonstrate 'tax track-record' and transparency when tendering for government procurement contracts	☐

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