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Hub Wealth Budget Review October 2020

Introduction

Last night the Federal Government handed down its Budget for the 2020–21 financial year. After going into a record deficit of $213.7 billion to support individuals and businesses during the Coronavirus crisis, the focus of this year's Budget is to regrow the economy by creating job opportunities and encouraging spending. Some key Budget announcements include:

- ✓ bringing forward the income tax cuts that were scheduled for 2022
- ✓ additional support payments for Age Pension and welfare recipients
- ✓ temporary full expensing to encourage business investment, and
- ✓ tax changes to help businesses offset their tax losses against past profits.

Finally, it's important to remember that the Budget announcements are still only proposals at this stage. Each of the proposals must be passed by Parliament before they're legislated. We have summarised in the following pages some of the measures that will most impact our clients. The table below provides an index to the areas we have covered.

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Tax

Personal tax cuts

Effective 1 July 2020

The Government has announced it will bring forward, by two years, stage two of the previously legislated tax cuts that were due to take effect from 1 July 2022. As a result, from 1 July 2020:

- the Low Income Tax Offset (LITO) will increase from $445 to $700. The increased LITO will be reduced at a rate of 5 cents per dollar for taxpayers that have taxable incomes between $37,500 and $45,000. The LITO will then be reduced at a rate of 1.5 cents per dollar for taxpayers that have taxable incomes between $45,000 and $66,667.
- the top threshold of the 19% tax rate will increase from $37,000 to $45,000, and
- the top threshold of the 32.5% tax rate will increase from $90,000 to $120,000.

The Government has also announced that the Low and Middle Income Tax Offset (LMITO), which was due to be removed with the commencement of the stage two tax cuts on 1 July 2022, will be maintained for the 2020-21 year only.

The first chart below summarises the impact of the tax changes overall.

Table 1: Personal tax rates, thresholds and offsets

2019/20 tax rates (excluding Medicare)	Stage 2 Income thresholds		Stage 3 Tax rates (from 1/7/2024)	Stage 3 Income thresholds (from 1/7/2024)
	For 2019/20	Proposed from 2020/21 to 2023/24		
0%	$0 - $18,200	$0 - $18,200	0%	$0 - $18,200
19%	$18,201 - $37,000	$18,201 - $45,000	19%	$18,201 - $45,000
32.5%	$37,001 - $90,000	$45,001 - $120,000	30%	$45,001 - $200,000
37%	$90,001 - $180,000	$120,001 - $180,000	Not applicable	Not applicable
45%	> $180,000	> $180,000	45%	> $200,000
LMITO	Up to $1,080	Up to $1,080 (2020/21 only)	LMITO	Nil
LITO	Up to $445	Up to $700	LITO	Up to $700

The table below illustrates the tax payable in future financial years and the potential tax savings compared to 2019/20 for a range of taxable incomes. These figures take account of the proposed personal income threshold and tax offset changes.

Taxable income	Tax payable in 2019/20	Proposed for 2020/21	
		Tax payable	Tax saved[1]
$40,000	$4,947	$3,887	$1,060
$80,000	$19,147	$16,987	$2,160
$120,000	$34,432	$31,687	$2,745
$160,000	$50,032	$47,467	$2,565
$200,000	$67,232	$64,667	$2,565

Business tax incentives

Date of effect: Various

Small business tax concessions

- Tax concessions to small businesses with a turnover of up to $50 million will be expanded as follows: From 1 July 2020, eligible businesses would be able to immediately deduct start-up expenses and certain pre-paid expenditure
- From 1 April 2021, eligible businesses will be exempt from fringe benefit tax (FBT) on car parking and multiple work-related portable electronic devices.
- From 1 July 2021, eligible businesses will have simplified trading stock rules, a change to calculation of Pay-As-You-Go instalments and changes to excise and customs duty. A two-year amendment period would apply for income tax returns starting 1 July 2021.

Fringe benefit tax exemption for training

Date of Effect: 2 October 2020

An exemption from FBT will be provided to employers providing training and reskilling to redundant or soon to be redundant employees. Ordinarily, FBT would apply if the training provided is not sufficiently connected to the current employment.

Government will also consult on possible changes for employees that undertake training at their own expense. Currently, a tax deduction is only available where the training relates to current employment.

Temporary full expensing of capital assets

Date of effect: From 7 October 2020

Businesses with an aggregated turnover of less than $5 billion will be able to deduct the full cost of eligible capital assets acquired from 7 October 2020 and used or installed by 30 June 2022. Also, in that period:

- Small businesses with an aggregated turnover of less than $10 million can claim a deduction for the full balance of their simplified depreciation pool, and
- Businesses with an aggregated turnover of less than $50 million can also expense second hand assets.

Temporary loss carry-back

Date of effect: 1 July 2020

Companies with an aggregated turnover of less than $5 billion can carry back losses in each of 2019/20, 2020/21 and 2021/22 tax years against any profits in 2018/19 or later years. The carry back will give rise to cash refunds of tax previously paid.

Comment The temporary loss carry-back measure will allow an eligible business to access their losses earlier and generate a cash refund to provide a needed cash flow boost for the corporate business. Although an eligible business is able to carry back their 2019-20 income year losses under this proposal, the information announced by the Government appears to suggest that the earliest time a company is able to receive the cash refund is after they lodge their 2020-21 income year tax return (i.e. after 30 June 2021).

Superannuation reform – Your Future, Your Super

Date of Effect: 1 July 2021

Super 'stapled' to a member

When a person starts a new job and does not nominate a super fund, employers will be required to contribute to the employee's existing super account, rather than the employer's default super fund. Under this measure, the existing super account will be 'stapled' to the member so that they keep their current super fund when they change jobs.

The aim of this measure is to improve member outcomes by reducing unintended multiple super accounts that erode member balances through unnecessary fees and insurance premiums. This measure implements Recommendation 3.5 of the Hayne Royal Commission. Employers will be able to obtain the new employee's existing super fund details from the ATO's online services. It is important to note that the opportunity to nominate a chosen fund is still available under this reform.

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Jobs and manufacturing

Date of Effect: 7 October 2020

JobMaker hiring credit

To support organisations in taking on new employees, the Government proposes to pay a hiring credit for up to 12 months for each new job. This is available from 7 October to employers who hire eligible employees age 16 to 35.

The credit will be paid quarterly in arrears at the rate of $200 per week for those age 16 to 29, and $100 per week for those aged 30 to 35. Eligible employees are required to work a minimum of 20 hours per week and receive the JobSeeker Payment, Youth Allowance (other) or Parenting Payment for at least one month out of the three months prior to when they are hired. To be eligible, employers will need to demonstrate an increase in overall employee headcount and payroll for each additional new position created.

Apprenticeships wage subsidy

Date of Effect: 5 October 2020 to 30 September 2021

Businesses of any size will be able to claim a new Boosting Apprentices Wage Subsidy for new apprentices or trainees who commence during this period. Eligible businesses will be reimbursed up to 50% of an apprentice or trainee's wages worth up to $7,000 per quarter, capped at 100,000 places. The wage subsidy will support school leavers and workers displaced by the Coronavirus-related downturn to secure sustainable employment.

Modern manufacturing strategy

Over five years from 2020-21

The Government will provide $1.5 billion over five years from 2020-21 to support the building of competitiveness, scale and resilience in the Australian manufacturing sector. Investment and support will focus on creating manufacturing strength and capability in six areas of comparative advantage and strategic interest. These six are: resources technology & critical minerals processing; food & beverages; medical products; recycling & clean energy; defence; and space.

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Social Security

Effective December 2020 and March 2021

$250 Economic Support Payments

The Government is providing two separate one-off Economic Support Payments of $250 to individuals receiving eligible income support payments or concession cards, paid progressively from December 2020 and March 2021. Eligible individuals must be in receipt of the following payments as at 27 November 2020 and/or 26 February 2021:

- ✓ Age Pension (including Age Pension (Blind))
- ✓ Carer Allowance* or Carer Payment
- ✓ Commonwealth Seniors Health Card
- ✓ Disability Support Pension (including Disability Support Pension (Blind))
- ✓ Double Orphan Pension*
- ✓ DVA Gold Card, DVA Payments or DVA Seniors Card
- ✓ Family Tax Benefit (fortnightly recipients)*
- ✓ Family Tax Benefit (lump sum recipients)*
- ✓ Pensioner Concession Card (PCC) holders (covers non-income and asset test PCC holders and customers who have an extended entitlement to a PCC even though payment has stopped).

* if they are not receiving a primary income support payment.

Comment: People eligible for the Coronavirus Supplement of $250 per fortnight, such as those on Jobseeker, are not eligible for the one-off $250 Economic Support Payment. Also, if a person only holds a Low Income Health Care Card, they do not qualify for the one-off $250 Economic Support Payments.

Youth Allowance and ABSTUDY independence test

Effective 1 January 2021

The Government is making a temporary change to the criteria used to determine independence for Youth Allowance and ABSTUDY. The independence test is important as young people who are considered independent from their parents are not subject to the Parental Income Test.

There are a number of ways of meeting the independence test; however, a common method is to meet the workforce participation criteria which require young people to work 30 hours per week for at least 18 months within a two-year period.

Under this temporary measure, from 1 January 2021 all Youth Allowance and ABSTUDY applicants will automatically be deemed to have worked over the six-month period from 25 March 2020 to 24 September 2020.

Comment: This measure will assist young people to meet the workforce participation criteria who were unable to obtain employment due to the economic impacts of Coronavirus while on a gap year in 2020.

Parental Leave Pay – Work test extension

Effective – Child born or adopted between 22 March 2020 and 31 March 2021

The Government is temporarily extending the work test for Paid Parental Leave and Dad and Partner Pay from 13 months to 20 months, for those affected by the Coronavirus pandemic. To be eligible for the extended work test, the individual must:

- ✓ not meet the current work test because their employment is impacted by the Coronavirus pandemic, and
- ✓ have a child born or adopted between 22 March 2020 and 31 March 2021.

For Parental Leave Pay, the work test period for these parents will be extended from 13 months to 20 months before either the:

- ✓ birth or adoption of their child, or
- ✓ start of their Dad and Partner Pay period.

This means work undertaken by the parent before Coronavirus can be counted towards the work test. In the extended 20-month work test period, these parents will need to meet the work test requirements of:

- ➢ 330 hours in a 10-month period, and
- ➢ no more than a 12-week break between work days.

DVA Disability Pensions – exempt for rent assistance and income support payments

Effective – Measures staggered between 1 July 2021 and 20 Sept 2022

A number of changes will be made to the DVA Disability Pension including:

- ✓ exempted from the Social Security Act income test
- ✓ exempted from the calculation of rent assistance under the Veterans Entitlement Act
- ✓ renamed Disability Compensation Payment.

Pension Loans Scheme – additional resources

Effective June 2021 and ongoing

The Government is making the following improvements to the services available to customers regarding the Pensions Loan Scheme:

- ➢ loan calculator to help people test their eligibility and estimate loan balances
- ➢ electronic loan repayments
- ➢ online services to make changes to loan terms and print itemised statements
- ➢ improved access to specialist staff
- ➢ joint online claim for partnered customers
- ➢ ability to complete regular loan reviews online.

Aged care

More funding for Home Care packages
Effective from 2020-21

The Government will improve waiting times for Home Care Packages by increasing funding for 23,000 additional home care packages across all package levels. In addition, improvements will be made to navigating the aged care system including classifying the care needs of older Australians through one unified system.

Exempting granny flat arrangements from capital gains tax
Date of Effect: 1 July 2021 Potentially

The Government announced that it will provide a targeted capital gains tax (CGT) exemption for granny flat arrangements where there is a formal written agreement. The measure will have effect from the first income year after the date of Royal Assent of the enabling legislation (i.e. as early as 1 July 2021 subject to the passing of legislation).

- ✓ A granny flat arrangement can provide a solution for an older or disabled person who may not be able to continue living an independent lifestyle and would like to move closer to a relation. It usually involves: an older or disabled person 'paying' for a life interest or right to accommodation for life in a private residence that is to be the person's principal home, and
- ✓ the residence not being owned by the individual, their partner, or an entity that they control.

Under the existing rules, the ATO in tax ruling TR 2006/14 confirms that CGT event D1 may occur on the creating of the right to reside in the family member's dwelling. The tax consequences can be a key impediment to families creating formal and legally enforceable granny flat arrangements, and

Under the proposed measure, CGT will not apply to the creation, variation or termination of a formal written granny flat arrangement providing accommodation for older Australians or people with a disability. The measure is consistent with the Government's National Plan to Respond to the Abuse of Older Australians announced on 19 March 2019, the Board of Taxation's Review of Granny Flat Arrangements, and the 2017 Australian Law Reform Commission's Report: Elder Abuse—A National Legal Response.

Economic Implications and Outlook

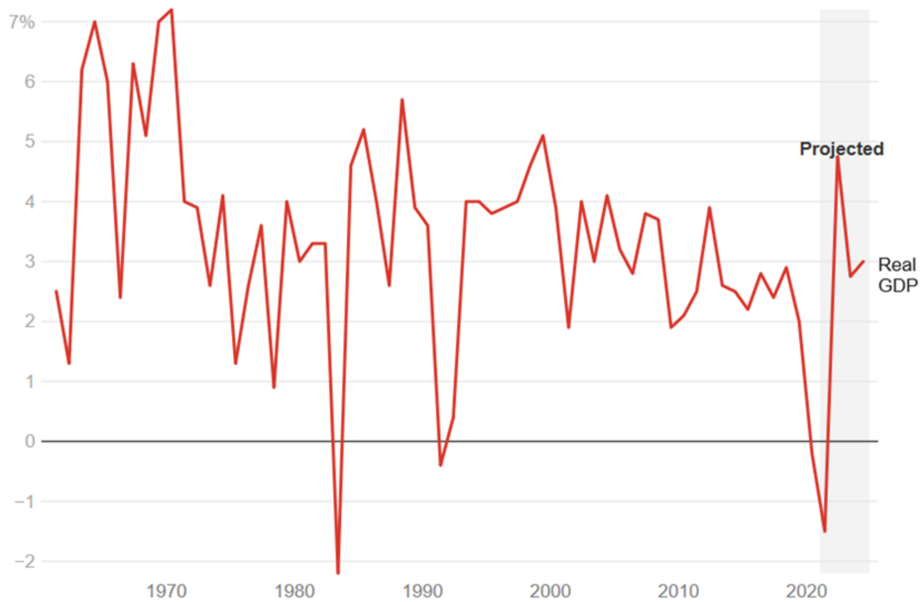
Economic and fiscal outlook

Along with the usual economic and fiscal forecasts, this budget has required **assumptions** around the evolution of the COVID outbreak and the provision of a vaccine. It assumes that localised outbreaks may occur but are largely contained. A population-wide COVID-19 vaccination is assumed to be available by late 2021. Whilst there are some uncertainties around the timeline for a vaccine, this assumption is in line with other forecasts, including the Good Judgement Project. The Budget also includes funding to secure access to more than 84 million doses of a potential vaccine candidate developed by either Oxford University or the University of Queensland.

Moving now to the economic forecasts, real **Gross Domestic Product** (GDP) is expected to fall by 1.5% in 2020/21 and then rebound by 4.75% in 2021/22. However, the budget expects the output gap (i.e. the gap between actual activity and potential activity) to be positive until 2024, which will limit the inflationary pressures in the economy. Realistically, at least some of the boost to disposable income is likely to be saved or used to pay down debt, given the very high level of household debt. Budget estimates project these measures will provide a 2.5% boost to GDP in 2021/22.

Past and projected GDP growth

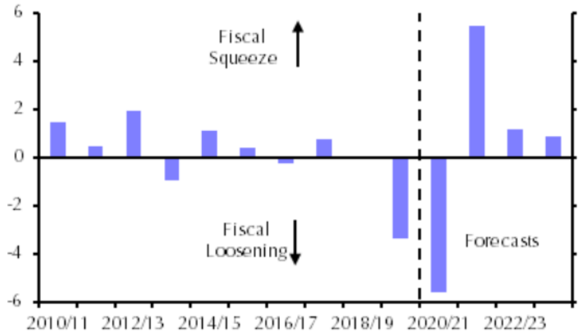
% growth, 1961 to 2024 (2021 to 2024 Budget projections).



Source: ABS and Budget.gov.au • Get the data

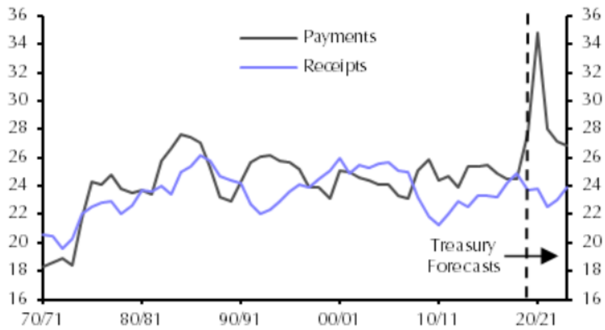
The charts below give an indication of the outlook over the next few financial years for **the budget.**

Chart 1: Structural Budget Balance (Annual Change, % of GDP)



Sources: Australian Treasury, Capital Economics

Chart 2: Federal Payments & Receipts (% of GDP)

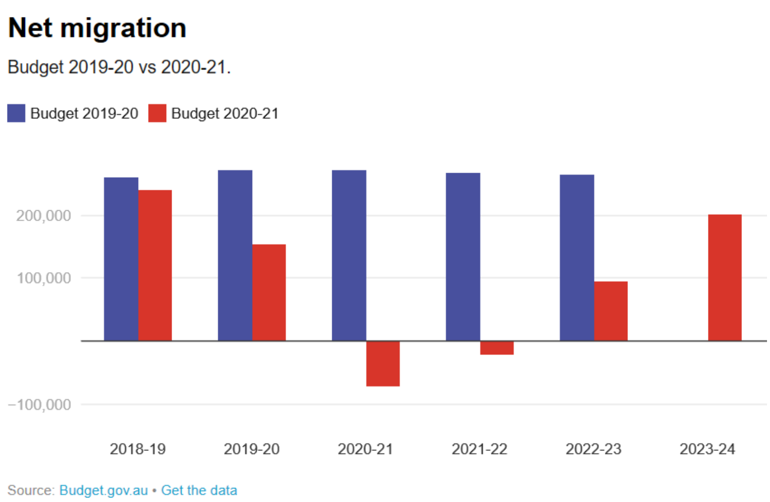


Source: Australian Treasury

The budget is expected to remain in deficit through to 2023/24, with annual deficits running from 11% of GDP in 2020/21 down to 3% in 2023/24. Gross federal government debt is set to hit 52% of GDP by 2024 and factoring in the ballooning debt of the states, Capital Economics estimate that general government debt will reach around 77% of GDP.

However, it is also expected that 10-year Australian government bond yields will remain around 0.75% over the coming years. Given that the average interest rate on Australian government bonds was a much higher 2.4% in 2019/20, **Capital Economics expect net debt servicing costs to fall from 0.7% of GDP now to 0.5% by 2023/24.** Given the spare capacity that will remain in the economy, this continued spending will provide support to domestic demand.

While many of the budget measures are designed to stimulate the economy, **net migration** has been an important element of this since World War II. For this year and next, net migration is expected to be negative i.e. more people permanently leaving than entering the country – the first time since 1946.



The Budget is forecasting the **unemployment rate** to peak at 8% by the end of this year, and then to fall to 6.5% by mid-2022. It says the "effective unemployment rate", which counts as unemployed people who are working zero hours (because of JobKeeper or other reasons) peaked at close to 15% in April, before sliding to around 9.25%. Unemployment is projected to remain above 6% through to 2022/23, which is important, as the Treasurer has noted that the government would not be looking to tighten fiscal settings before the unemployment rate is comfortably below that level.

Potential Investment Implications

This budget is very clearly targeting growth. The aim is to restore consumer and business confidence, but much relies on maintaining covid outbreaks, successful delivery of a vaccine, and avoiding a "cliff" as JobKeeper and Jobseeker benefits are gradually withdrawn. In that environment, it is to be expected that we will see increasing consumer delinquencies, rising unemployment and business failures.

However, this budget certainly does attempt to shore up the economy, and provides investors with a clear view that the Government (and Reserve Bank) are likely to provide even further stimulus if needed. In this environment, **some sectors of the economy and stock market may well prosper**: retailers, including potentially car sales; and domestic travel, given the likelihood that overseas travel will remain difficult. Domestic building and infrastructure sectors should also benefit. Selected listed property trusts may also offer opportunity as confidence returns.

Conversely, the residential property outlook remains muted, given the lack of immigration and unemployment outlook. Banks will be hoping that their debt provisions are sufficient. Valuations in some IT and "buy now pay later" companies may fall back as reality returns.

For **defensive assets** (cash, fixed interest, credit), there is no prospect of income yields increasing. It is reasonably likely that our Reserve Bank will lower rates even further next month, and continue purchasing Government Bonds to bring long-term interest rates down. Those measures will again provide a positive backdrop for growth assets, but make portfolio construction difficult given the very low returns available. The prospect of minimal inflation is some consolation here.

For the **Australian dollar**, the outlook is notoriously unpredictable. Increasing debt would normally put the currency under pressure, but our debt position relative to countries such as the UK, USA and Japan remains modest. The AAA credit rating remains in place. Much will actually depend on how other countries approach both the health and economic situation. The prospect of ongoing difficulties with covid, politically and economically elsewhere may actually give strength to the $A against some other currencies over the next few years.

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The information provided herein is of a general nature only, and represents our summary of the issues outlined. It is not a full outline of all issues – only those we think relevant to most of our clients, along with our interpretation of the information and its meaning. The information also does not take into account your personal circumstances or objectives, and we note again that these are only proposals at this stage – they have yet to be enacted into any legislation.

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