A Budget for Infrastructure

Overview

Throughout the lead up to the 2018/19 Federal Budget the government was uncharacteristically tight lipped about how it will effect industry. Adjustments to the marginal income tax rates, investment in major infrastructure projects and a number of measures for health, education and social assistance have been the main focus of the Government's pre-budget sales pitch. These will no-doubt be covered extensively in the mainstream media.

The Budget measures announced tonight that will impact on residential building and housing businesses include:

- A Tax Integrity measure which denies deductions for vacant land;
- Extending the $20,000 instant asset write off
- Better targeting the research and development tax incentive
- A number of measures relating to the Black Economy Task Force
    - Further expansion of taxable payments reporting
    - New and enhanced ATO enforcement
    - Removing tax deductibility of non-compliant payments
    - Introduction of an economy-wide cash payment limit
- Funding for the ABS for Improving Housing Related Data
- Funding for Australian Housing and Urban Research Institute — National Housing Research Program
- Divestment of Commonwealth land for residential development in Brisbane
- Remote Indigenous Housing in the Northern Territory
- Cuts to funding for the Industry Workforce Training program
- Additional funding for Trades Recognition Australia
- Round three of the Building Better Regions Fund
- ACCC Commercial Construction Unit — extension
- Commonwealth Ombudsman — additional funding for oversight of ABCC
- Extra funding for the Western Sydney City Deal
- Funding for the Launceston City Deal

These measures are discussed in more detail in the following section.

Key Budget Measures

Tax Integrity — deny deductions for vacant land

The Government will deny deductions for expenses associated with holding vacant land. This is an integrity measure to address concerns that deductions are being improperly claimed for expenses, such as interest costs, related to holding vacant land, where the land is not genuinely held for the purpose of earning assessable income. This measure will take effect from 1 July 2019.

Expenses for which deductions will be denied that would ordinarily be a cost base element (such as borrowing expenses and council rates) may be included in the cost base of the asset for capital gains tax (CGT) purposes when sold. However, denied deductions for expenses that would not ordinarily be a cost base element would not be able to be included in the cost base of the asset for CGT purposes.

This measure will not apply to expenses associated with holding land that are incurred after:

- a property has been constructed on the land, it has received approval to be occupied and is available for rent; or
- the land is being used by the owner to carry on a business, including a business of primary production.

This measure will apply to land held for residential or commercial purposes. However, the 'carrying on a business' test will generally exclude land held for commercial development.

This measure is estimated to have a gain to revenue of $50.0 million over the forward estimates period.

Extending the $20,000 instant asset write off for businesses with a turnover up to $10 million

The existing $20,000 instant asset write off that is available for businesses with an annual turnover of up to $10 million is to be extended for a further year.

Better targeting the research and development tax incentive

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

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

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

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

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

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

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

Black Economy Package — further expansion of taxable payments reporting

The Government will further expand the taxable payments reporting system (TPRS) to the following industries:

- security providers and investigation services;
- road freight transport; and
- computer system design and related services.

This measure is in response to the Black Economy Taskforce findings that contractors in these industries have been identified by the ATO as being at higher risk of not complying with their tax obligations. The TPRS is an integrity measure and already operates in the building and construction industry. In the 2017-18 Budget, the TPRS was extended to the cleaning and courier industries commencing from 1 July 2018.

Under the TPRS, businesses are required to report payments to contractors to the ATO. This brings payments to contractors in these industries into line with wages which are reported to the ATO. These new business categories will need to ensure that they collect information from 1 July 2019, with the first annual report required in August 2020. A new online form will make the reporting process easier.

The measure will have effect from 1 July 2019 and is estimated to have a net gain to the budget of $605.8 million in fiscal balance terms over the forward estimates period. In underlying cash balance terms, this measure has a net gain of $545.8 million over the forward estimates period.

Black Economy Package — introduction of an economy-wide cash payment limit

The Government will introduce a limit of $10,000 for cash payments made to businesses for goods and services from 1 July 2019. As part of implementation the Government will consult on the detail of this measure.

Large undocumented cash payments can be used to avoid tax or to launder money from criminal activity. This measure will require transactions over the threshold to be made through an electronic payment system or by cheque. Transactions with financial institutions or consumer to consumer non-business transactions will not be affected. This action was recommended by the Black Economy Taskforce in order to tackle tax evasion and money laundering.

Black Economy Package — new and enhanced ATO enforcement against the Black Economy

The Government will provide $318.5 million over four years to implement new strategies to combat the black economy. The ATO will implement a new and enhanced enforcement strategy that brings together new mobile strike teams and an increased audit presence, a Black Economy Hotline that will allow for the community to report black economy and illegal phoenix activities, improved government data analytics, and educational activities. This strategy will support the new multi-agency Black Economy Standing Taskforce to ensure a more coordinated approach to combatting the black economy behaviours through improved government data analytics and information sharing between enforcement agencies. This measure is estimated to have a gain to revenue of $3.0 billion over the forward estimates period. The underlying cash receipts impact is estimated to be $2.5 billion over the forward estimates period.

The ATO currently receives funding through a terminating program Black Economy Taskforce: the one year extension of funding for ATO audit and compliance activities which ceases on 30 June 2018.

The Black Economy Taskforce found that existing laws to deal with the black economy are ineffective as deterrents if there is low level enforcement and low visibility of enforcement. Feedback from industry, business and community stakeholders supported additional resourcing to the ATO in recognition of the enforcement challenges due to the size and clandestine nature of the black economy.

Black Economy Package — removing tax deductibility of non-compliant payments

Businesses will no longer be able to claim deductions for payments to their employees such as wages where they have not withheld any amount of PAYG from these payments, despite the PAYG withholding requirements applying.

The Government will also remove deductions for payments made by businesses to contractors where the contractor does not provide an ABN and the business does not withhold any amount of PAYG despite the withholding requirements applying.

The measure will have effect from 1 July 2019.

Improving Housing Related Data

The Government will provide $4.8 million over four years from 2018-19 to the Australian Bureau of Statistics to construct better estimates of the stock of affordable housing and to improve existing survey-based planning and zoning data and dwelling construction cost collections.

The Government will also provide $0.2 million in 2018-19 to the Australian Institute of Health and Welfare to bring together all major housing and homelessness data in a user friendly dashboard.

Australian Housing and Urban Research Institute — National Housing Research Program

The Government will provide $5.5 million over three years from 2018-19 to continue funding provided to the National Housing Research Program of the Australian Housing and Urban Research Institute. The program provides an evidence base to support the development of future housing, urban development and homelessness policies.

Divestment of Australian Communications and Media Authority property

The Government will divest land currently owned by the Australian Communications and Media Authority in the Redland City local government area, Queensland, in 2019-20. The property divested can support up to 400 homes and will increase the supply of land for housing in metropolitan Brisbane.

This measure builds upon the 2017-18 MYEFO measure titled Reducing Pressure on Housing Affordability — unlocking Commonwealth land.

Remote Indigenous Housing in the Northern Territory

The Government will provide $550.0 million over five years from 2018-19 (including $110.0 million in 2022-23) for a new five-year bilateral agreement with the Northern Territory Government on Remote Indigenous Housing.

Funding will be provided to the Northern Territory Government to continue to provide property and tenancy management and to address severe overcrowding in remote communities.

Industry Workforce Training program — efficiencies

The Government will achieve efficiencies of $21.2 million over four years from 2018-19 by discontinuing the competitive funding stream of the Industry Workforce Training program.

Trades Recognition Australia — additional funding

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

Building Better Regions Fund — round three

The Government will provide $206.5 million over four years from 2018-19 for round three of the Building Better Regions Fund, to support investment in community infrastructure and capacity building projects in regional areas.

Commonwealth Ombudsman — additional funding

The Government will provide $1.4 million over five years from 2017-18 to the Office of the Commonwealth Ombudsman for oversight of the Australian Federal Police (AFP) and the Australian Building and Construction Commission (ABCC). This funding will formalise existing oversight arrangements, which are funded by the AFP and the ABCC. The cost of this measure will be met from within the existing resources of the AFP and the ABCC.

Commercial Construction Unit — extension

An additional $3.0 million will be committed over two years from 2018-19 to the Australian Competition and Consumer Commission to continue its investigations into competition issues within the commercial construction sector as part of the Government's ongoing response to the Royal Commission into Trade Union Governance and Corruption.

Western Sydney City Deal

$125.0 million will be committed over five years ($95 million previously announced) from 2017-18 to support infrastructure projects and initiatives under the Western Sydney City Deal, including:

• up to $50.0 million towards the development of a business case for Western Sydney Rail, including an investigation of integrated transport and delivery options for a full North South Rail Link from Schofields to Macarthur, to be funded on a 50:50 basis with the NSW Government;

• $60.0 million to improve community infrastructure in Western Sydney; and

• $15.0 million to accelerate planning and zoning reforms to support housing supply in Western Sydney.

Launceston City Deal — Tamar River

$47.5 million will be committed over five years from 2019-20 towards 12 projects to reduce pollution and improve the health of the Tamar River in Launceston, Tasmania, as part of the Launceston City Deal.

Economic Backdrop & Fiscal Position

Last year's Budget marked a shift towards a more expansionary fiscal strategy and the first step in moving beyond the 'budget emergency' era while maintaining the objective of returning to surplus within the forecast horizon. With the economy on a solid footing and a federal election looming on the horizon, the 2018/19 Budget was never going to be one that saw the Government deviate from the course they set out on last year.

The Mid-year Economic and Fiscal Outlook (MYEFO) released in late 2017 gave us the first concrete indication that the Government's budget was in a better condition than they had been expecting. Business tax revenue had exceeded expectation and welfare expenditure was under budget thanks to the strong employment growth.

At the time of last year's Budget the deficit for 2017/18 was projected to be $23.6bn and the projection was lowered to $18.2bn by mid-year and this remains the expectation. The Budget projections for future years are now far more positive. MYEFO projected a $20.5bn deficit for 2018/19 before a further $2.5bn deficit in 2019/20 before returning to a surplus of $10.2bn in 2020/21. The projections in the 2018/19 Budget now see the deficit in 2018/19 cut to $14.5bn with a surplus of $2.2bn the following year, twelve months ahead of schedule. The Government will claim this as evidence of their astute fiscal management. While this may be partially valid the boost provided by the stronger global economic environment should not be forgotten.

Projections about the economic conditions during the upcoming year and across the forecast horizon are an integral part of the budget process, however the economic outlook prepared by the Commonwealth Treasury also provides a good guide for businesses planning.

Recent reports from the Reserve Bank of Australia, which received media coverage last week, provided a 'sneak peek' into the economic backdrop for the Budget. While the RBA are independent of the Government, when it comes to economic forecasts, they are usually on the same page. The key economic assumptions on which the Budget was developed are summarised in the table below.

Key Treasury Forecasts underlying Budget 2018-19:

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Underlying Cash Balance ($ billions)	-33.2	-18.2	-14.5	2.2	11.0	16.6
Underlying Cash Balance (Per cent of GDP)	-1.9	-1.0	-0.8	0.1	0.5	0.8
Unemployment Rate	5.6	5.5	5.25	5.25		
Inflation Rate	1.9	2.0	2.25	2.5		
Real GDP Growth	2.1	2.75	3.00	3.00		
Dwelling Investment Growth	2.8	-3.00	1.50	0		
Total business investment Growth	-4.0	4.50	3.00	4.50		
Mining investment	-24.2	-11.00	-7.00	3.50		
Non-mining investment	6.1	10.50	5.50	5.00		

In terms of the economic assumptions underlying the Budget projections, the Treasury foresees the rate of economic growth achieving 2.75 per cent in 2017/18 (up from 2.5 per cent forecast in MYEFO), before strengthening to the long term trend rate of 3.0 per cent in 2018/19 and then remaining steady at that level over the forecast horizon.

Projections for metallurgical coal and iron ore prices have an important bearing on government revenue and there will inevitably be questions about their reliability or implied optimism. In reality commodity prices tend to be volatile. The assumed price of thermal coal and oil have increased since MYEFO which will positively effect on the projected budget outcomes. Should the prices for Australia's key export commodities fall below the projections then underlying cash deficits could persist beyond the current projections.

The improved outlook for economic growth should create more jobs and put downward pressure on the unemployment rate. Unemployment has been stuck at around 5.5 per cent over the last year but is projected to ease to around 5.25 per cent next year and remain at that level over the forecast horizon.

Consistent with recent commentary from the RBA, the rate of inflation is expected to continue rising, albeit gradually, from around 2.0 per cent this year to around 2.5 per cent by 2019/20. This inflationary profile implies that the next move in the official cash rate is likely to be up, but the RBA will not be in any rush to do so.

Residential building activity has declined from the peak of the cycle back in 2016, it is expected that investment in housing during 2017/18 declined by around 3.0 per cent. The outlook for residential building in 2018/19 is more optimistic, with Treasury forecasts projecting growth of 1.5 per cent. This is a markedly improved outlook when compared with the 4.0 decline in investment Treasury forecast for 2018/19 in last year's budget.

For further information regarding Budget 2018/19, please contact the HIA Economics Team:

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