Insight Beyond the obvious

Federal Budget Brief 2014

A review of the Budget's major business implications

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Executive summary

Balancing the books longer term

The 2014-15 Federal Budget focussed on the expenditure side of the ledger for the longer term together with two revenue raising measures to substantially reduce the forecasted budget deficits.

In the lead up to the Budget, the National Commission of Audit and economic commentators had a long list of recommendations on how to quickly put a stop to a decade of projected deficits.

This Budget reduces the 2014-15 deficit by approximately $20 billion compared with the projected result for the current year and by approximately $4 billion compared with the December 2013 mid-year forecasts, although a significant proportion of this is due to changes in underlying economic conditions.

In essence, the Government's strategy centres on expenditure savings in the areas of health service contributions, foreign aid, education loan programs, family and other welfare benefits. Coupled with the reintroduction of fuel excise indexation and a personal tax increase, the Budget savings dramatically reduce the forecasted deficits but also make room for redirected expenditure priorities in infrastructure and the establishment of a Medical Research Future Fund.

Key decisions in the Budget include:

- Revenue measures
  - The reintroduction of fuel excise indexation from 1 August 2014.
  - A 2 percent increase in the highest marginal personal tax rate from 1 July 2014 until 30 June 2017.
  - The 1.5 percent reduction in the company tax rate to 28.5 percent will proceed from 1 July 2015.
- Expenditure measures
  - The paid parental leave scheme, with a lower maximum payment cap, will proceed from 1 July 2015. This will be funded by a 1.5 percent levy on companies with taxable income above $5 million.
  - Industry assistance programs are to be pared back.
  - Greater restrictions will apply to some welfare payments, including the tightening of eligibility for family payments. Co-contribution healthcare payments will also commence from 1 July 2015 with these funds being directed into medical research.
  - Additional federal infrastructure spending of approximately $12 billion is planned over the next 6 years which includes the Government offering financial incentives to the States and Territories of $5 billion under the infrastructure recycling initiative over the period to 30 June 2019.
  - Tightening of the age pension will not commence until September 2017 and the lifting of the retirement age to 70 years will not occur until 2035.

What does this mean for business?

The different impacts of this new budgetary framework are starkly evident when you compare business models that have dependencies linked to social or industry welfare programs as against those that are focussed on infrastructure.

The revenue projections in this Budget also make a strong case for tax reform. They demonstrate the impacts of a current tax mix that has not heeded the warnings of the Henry Review. Moreover, consideration of superannuation and the goods and services tax have been deferred and a domestic response to the global problem of tax base erosion is still outstanding. Accordingly, there will be growing anticipation for the release of the 2015 White Papers on Taxation and Federation Reform.

Gary Wingrove
Chief Executive Officer

Economic and fiscal analysis

Stable inflation and a sound fiscal position collude to provide the Government with a full range of macroeconomic policy levers from which to base policy solutions to emerging economic challenges.

The Australian economy is a dynamic system. The last decade has been a period of rapid structural adjustment to a high terms-of-trade, high-investment economy driven by a resources construction boom responding to surging emerging-market demand. Manufacturing and services have faced significant challenges, with high wages growth, a strong exchange rate and keen competition for investment funds eroding competitiveness. The next decade for Australia, in part, will be a story of transition to the operational phase for resources (with high growth in minerals, energy and agriculture exports to emerging nations) and a restructuring of manufacturing and services. It will also be a tale of emerging macroeconomic policy challenges, particular for Treasury.

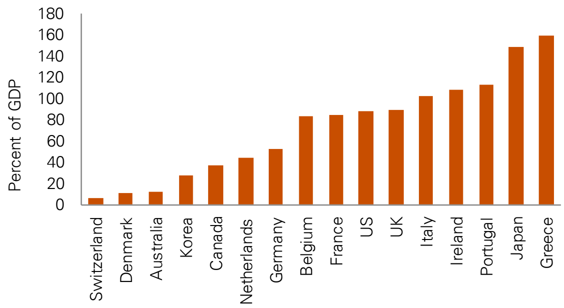
In the short term, GDP growth is expected to remain stable but just below trend in 2014, with a modest recovery and improving labour market conditions in 2015. The RBA has continued its 20 year record of competent monetary management, a period of historically large movements in the exchange rate and the terms of trade, with stable inflation and interest rates.

Australia faces some emerging fiscal challenges, but enjoys an enviable position on the public sector balance sheet. Both gross and net public sector debt remain low by international standards, and the budget deficit, while recently expanding, is not yet at critical levels. However, demographic and other long-term structural factors are eroding the tax base and increasing pressure on public expenditure, and we now believe the base of the existing tax system has peaked and is in decline.

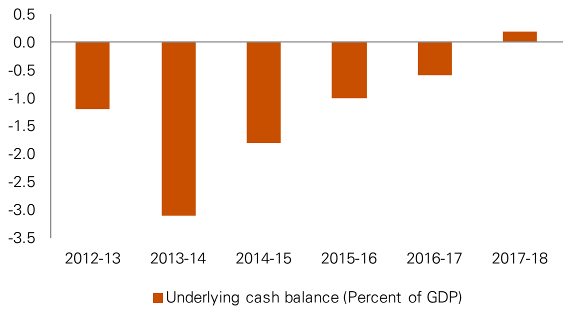
We support the broad aim of fiscal reform designed to improve the structural budget position over the medium term. Reform of the revenue side – on efficiency and revenue-adequacy grounds – is overdue and should be pursued as a priority.

If implemented in a way that avoids unnecessary disruption of near-term growth prospects, appropriately designed measures to strengthen the tax base and control spending growth will increase fiscal buffers and enhance policy headroom available for adverse shocks and the likelihood of an increasingly volatile global economy.

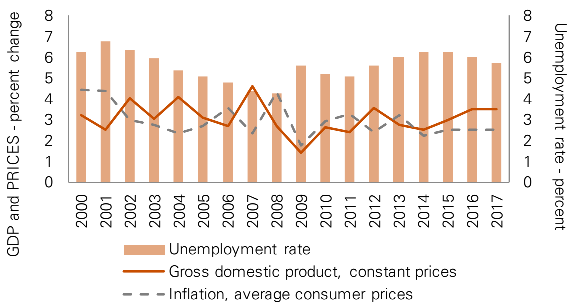
Government Net Debt



Underlying cash balance



A sound macro economy



Source: Federal Budget papers and IMF publications

Key insights

- Commitment to fiscal reform will strengthen macroeconomic policy buffers, increasing policy headroom in responding to shocks in an increasingly volatile global economy.
- Both expenditure and revenue reform will be required in the long run. The timing of reform should be sensitive to macroeconomic vulnerabilities as well as the hard arithmetic of budgeting and debt accumulation.

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

	2013-14	2014-15	2015-16	2016-17	2017-18
GDP (Real)	2.75%	2.5%	3.0%	3.25%	3.25%

The resource sector is transitioning from an investment phase to production and exports. Higher resource exports will make the economy more sensitive to terms of trade shocks, and the floating exchange rate will be an important buffer.

Growth in real GDP	2014-15
United States	3.0%
Canada	2.4%
United Kingdom	2.5%
Japan	1.0%
China	7.3%

Unemployment rate – trend downwards very slowly

	2013-14	2014-15	2015-16	2016-17	2017-18
Unemployment	6.0%	6.25%	6.25%	6.0%	5.75%

Labour market conditions have stabilised a little and are expected to recover very gradually. The unemployment rate is expected to peak at 6.25%, largely due to the emerging spare labour capacity in mining sector amid the declining terms of trade.

Unemployment rate	2014-15
United States	6.2%
Canada	6.9%
United Kingdom	6.6%
Japan	3.9%
China	4.1%

Consumer price index – within band

	2013-14	2014-15	2015-16	2016-17	2017-18
CPI	3.25%	2.25%	2.5%	2.5%	2.5%

Inflation remains within the target band and is expected to do so in the medium term. Expectations of a depreciating Australian dollar are expected to pose upward pressure on inflation over the projection period.

CPI	2014-15
United States	1.6%
Canada	1.9%
United Kingdom	1.9%
Japan	1.7%
China	3.0%

Public debt as a percentage of GDP

	2013-14	2014-15	2015-16	2016-17	2017-18
Public debt	12.5%	13.9%	14.4%	14.6%	14.0%

Net debt as a percentage of GDP – a key measure of fiscal sustainability – remains low by international standards, and is expected to increase in the medium term.

Debt as a percentage of GDP	2014-15
United States	83%
Canada	40%
United Kingdom	86%
Japan	140%
China	n/a

Source: IMF

Personal tax

Temporary Budget Repair Levy

From 1 July 2014 until 30 June 2017, a 2 percent levy will be imposed on individuals' taxable income above $180,000.

This means that for an individual with earnings of $250,000 in the 2015 financial year, they will pay an additional levy of $1,400.

Fringe benefits tax (FBT)

With the introduction of the Temporary Budget Repair Levy to apply from 1 July 2014, there will also be an increase in the FBT rate to 49 percent.

This increase is due to take effect from 1 April 2015.

Employers should also note that in addition to the increase in the FBT rate, there is a consequential adjustment to the FBT gross up rates of 2.1463 where an employer is entitled to an input tax credit and 1.9608 where an employer is not entitled to a credit.

Family payments

The Budget announced changes to the means testing of Family Tax Benefit Part B as follows:

The youngest child must be aged less than 6 years in order to receive the payment (subject to grandfathering provisions).

The primary income threshold will reduce from $150,000 to $100,000 per year.

Other measures

Other measures announced include:

- Individuals will have the opportunity to withdraw excess non-concessional superannuation contributions rather than pay additional tax for contributions made from 1 July 2013.
- The superannuation guarantee rate will increase to 9.5 percent effective 1 July 2014.No further increases to superannuation guarantee will occur until 1 July 2018.
- The Mature Age Workers Tax Offset will be abolished from 1 July 2014.
- The Dependent Spouse Tax Offset will be removed from 1 July 2014.
- Changes to the Higher Education Loan Program repayment scheme.

"The introduction of the Temporary Budget Repair Levy takes Australia's top marginal tax rate to 49 percent. This will make tax effective strategies, including negative gearing, more attractive".

Ben Travers
Partner, International Executive Services

Current rates for 2014/2015 financial year*		**Proposed rates for 2014/2015 financial year inc. levy***	
Resident thresholds $	**Marginal rate (%)**	**Resident thresholds $**	**Marginal rate (%)**
Up to 18,200	0	Up to 18,200	0
18,201 to 37,000	19.0	18,201 to 37,000	19.0
37,001 to 80,000	32.5	37,001 to 80,000	32.5
80,001 to 180,000	37.0	80,001 to 180,000	37.0
180,001+	45.0	180,001+	47.0

* Excluding Medicare levy (2 percent in 2014/2015 financial year)

Key insights

- The tightening of welfare benefits will impact the disposable income of middle income taxpayers.
- The widening differential between the top marginal rate of tax (49 percent) for individuals and the lower corporate tax rate (28.5 percent from 1 July 2015) may result in the more frequent use of companies as investment vehicles.
- Australian employers are likely to find it more difficult to attract and retain key talent due to relatively higher marginal rates of tax, relative to most other countries.
- The Government has not addressed the adverse impact that the current employee share scheme rules have on innovation.

Business tax

Five main changes

1 Company tax cut and paid parental leave levy

The Government confirmed its intention to reduce the corporate tax rate to 28.5 percent from 1July 2015. For companies with taxable income in excess of $5 million, this reduction will be offset by a new levy of 1.5 percent which will fund the Government's paid parental leave scheme.

Coupled with these changes, the Government has announced that it will reduce the rate of the refundable and non-refundable research and development tax offsets by 1.5 percent from 1 July 2014.

2 Managed investment trusts (MITs)

Following recent consultation, the Government remains committed to introducing a new regime for MITs, with Exposure Draft legislation to be released for public consultation in June 2014.However, the introduction of the new regime has been deferred to 1 July 2015 to accommodate this consultation and the need for systems changes by the ATO and industry.

3 Tax consolidation changes

A new measure has been announced to ensure consistency between the treatment of securitised assets and associated liabilities in tax consolidation entry and exit scenarios. Transitional rules will apply to arrangements that commenced before 13 May 2014.

Certain tax consolidation integrity measures announced in the 2013-14 Budget (regarding shifting of assets and deductible liabilities) will be deferred to apply to arrangements commencing on or after the original announcement (14 May 2013).

4 MEC groups

The Government has decided not to proceed with changes to multiple-entry consolidated (MEC) groups, as announced in the 2013-14 Budget. This decision followed the conclusions of a working group (comprising Treasury, ATO and industry participants), which concluded that there is limited scope to address differences between MEC and ordinary tax consolidated groups without reconsidering broader international tax policy issues.

5 Third party reporting

Whilst the Government is still committed to enhance third party reporting to the ATO to enhance taxpayer compliance, the commencement date for certain tax-related information has now been deferred to 1 July 2016 (for real property, shares, units, derivatives, certain government grants/payments and merchant debit/credit services).This follows concerns raised by industry on a recent Treasury discussion paper.

Country	Corporate Tax Rate 2014 (%)	Indirect Tax Rate 2014 (%)
United States*	40.0	0
Japan	35.6	8.0
India	34.0	14.0
Australia	30.0	10.0
Germany	29.6	19.0
Canada	26.5	5.0
Brazil	25.0	19.0
China	25.0	25.0
United Kingdom	21.0	20.0
Singapore	17.0	7.0
OECD average	25.3	19.1

Source - KPMG Tax Rates Online

** The marginal federal corporate income tax rate on the highest income bracket of corporations is 35 percent. State and local governments may also impose income taxes, generally resulting in a net effective rate of approximately 40 percent.*

Business tax

Key insights

- Business tax changes were limited, as many of the Budget measures focused on expenditure savings (e.g. savings of $7.6 billion are forecast over 5 years by limiting foreign official development assistance growth).This also reflects recent work by the Government in reviewing and deciding whether to proceed with, or abandon, a large number of outstanding, unenacted tax measures.
- The proposed company tax rate change and paid parental leave levy raise dividend planning and deferred tax issues.Absent any specific transitional rules to the contrary, franked dividends paid to shareholders after 30 June 2015 will only impute a 28.5 percent franking credit, notwithstanding a company's surplus franking credits at that date would reflect underlying tax paid at 30 percent.Proposed changes to the dividend payment rules under the Corporations Act also need consideration in 2015 dividend strategies.
- Announcements on tax consolidation, MEC changes and third party reporting are a welcome response to industry feedback and are consistent with the Government's intention to reduce red-tape.

Fully Franked Dividend Comparison

	Pre 1/7/15	Post 30/6/15
Dividend	100.00	100.00
Franking credit	42.86	39.86
Grossed up income	142.86	139.86
Shareholder tax rate (say 15%)	21.43	20.98
Franking credit	(42.86)	(39.86)
Refund	(21.43)	(18.88)

"The reduction in the company tax rate to 28.5 percent signals a recognition that international competition has returned to the global headline rates for business taxes, albeit sometimes paid for by alternative revenue raising measures.

Our domestic responses to the OECD's base erosion action plan and the Government's White Paper on Tax Reform will significantly impact our longer term competitiveness on business taxation".

David Linke
National Corporate Tax Leader

Tax reform

Tax reform roadmap

There were no new announcements on Budget night in relation to the Government's broader tax review agenda. The consultation process is expected to involve the release of a series of discussion papers, followed by a White Paper on taxation reform by the end of 2015.

Tax reforms over time

Tax reforms		Scope
1972	Asprey Review	Comprehensive review but implemented over the next 20 years
1985	Draft White Paper	Wide-reaching tax reform including capital gains tax (CGT) and fringe benefits tax (FBT)
1998	Ralph Review	Goods and services tax (GST) to replace sales taxes and certain state taxes
2009	Henry Review	Comprehensive review in the style of the Asprey Review but the terms of reference did not extend to GST
General Reforms		
Jun 2014	National Industry Investment & Competitive Agenda report	
Oct 2014	Productivity Commission's report on Childcare and Early Childhood Learning	
2014	Fourth Intergenerational Report	
End 2015	White paper on Tax Reform	
End 2015	White paper on Federation	

History of federal - state tax division

Major reforms	Date
Federation - income taxed at state level only	1901
Income taxed at both state and federal level	1915
Federal wholesale sales tax (WST) introduced	1930
Federal payroll tax introduced	1941
Income tax consolidated at federal level	1942
Control of payroll taxes ceded to the states	1971
Federal capital gains tax introduced	1985
Federal fringe benefits tax introduced	1986
GST introduced, GST revenue provided to states	2000

"Reforming Australia's tax system is a daunting but essential task. There is little consensus as to what the ideal system should be. However, properly thought through, a tax reform package shall provide a higher standard of living for all of us in the longer term".

Rosheen Garnon
National Managing Partner, Tax

Key insights

- The White Paper on Taxation Reform has close linkages with the other proposed White Paper on the Reform of the Federation, which is also due by the end of 2015.Draft terms of reference for both papers were considered at the recent Council of Australian Governments' (COAG) meeting.
- Much of the evidentiary analysis undertaken for the Henry Review is expected to form the bedrock of the current Government's tax reform agenda. However, its terms of reference are expected to be broader, and are anticipated to include GST, reform of state taxes, the reduction of red tape for businesses and options to encourage investment and innovation.

Infrastructure

Additional funding

Living up to Tony Abbott's aspiration of being known as the 'Infrastructure Prime Minister', infrastructure is the cornerstone of this Budget. The $11.6 billion Infrastructure Growth Package, together with existing announced projects, provides a total of $50 billion federal funding infrastructure commitment over the next 6 years. This funding, combined with state and private sector, is expected to generate a total of $125 billion investment in infrastructure across the nation. This substantial infrastructure investment will help support Australia's productivity in the long term and will be important in the short term in generating economic activity as the economy transitions from resource investment led growth.

The following table details the three components of the Infrastructure Growth Package and major new infrastructure project announcements:

The Infrastructure Growth Package

Project	New Federal Funding $bn
Western Sydney Infrastructure	$2.9
New Infrastructure Investments	$3.7
Asset Recycling Initiative	$5.0
Total	$11.6

Major New Infrastructure Project Funding

Project	State
Western Sydney Infrastructure Plan	NSW
Westconnex – Stage 2 (Concessional Loan)	NSW
East West Link – Stage 2	VIC
North South Road Corridor	SA
Toowoomba Second Range Crossing	QLD
Northern Territory Road upgrades	NT
Perth Freight Link	WA

In July 2014 with $5.9 billion of seed funding and managed by the Future Fund Board of Guardians the Asset Recycling Fund (ARF) will be established. The ARF will be a dedicated vehicle for providing funding and financial incentives primarily to the States and Territories to invest in infrastructure.

Under the Asset Recycling Initiative the Federal Government has agreed to provide a pool of capital(initially $5 billion) which the State Governments' can draw 15 percent of the value of their privatised assets. There are several conditions to access the capital, including proceeds be used for the construction of new "productive" infrastructure, above what State Governments have already committed. The assets to be sold and projects to be funded from proceeds over a 5 year period will be subject to bilateral agreement. Funding will be allocated to specific projects on a first-come, first-served basis, as projects are agreed between the Federal and individual State Governments.

Asset sales

"It is anticipated additional funding will flow into the ARF from Commonwealth asset sales. In 2014-15 the Government has allocated $11.7 million for scoping studies into future ownership options for Australian Hearing, Defence Housing Australia Ltd, the Royal Australian Mint and the registry function of the Australian Securities and Investments Commission.

The announcement of the $11.6 billion Infrastructure Growth Package together with existing announced infrastructure projects provides a total of $50 billion federal infrastructure funding, demonstrating the Federal Government's commitment to building productive infrastructure that will benefit all Australians now and in the future. This news has positive implications for the construction sector, investors and various public and private sector enterprises who can focus resources on pursuing these opportunities".

Paul Foxlee

National Head of Transport & Infrastructure, Partner

Key insights

- The infrastructure spend and government asset sale incentives will provide significant opportunities for the construction sector, financial institutions and funds, and private sector operators and create significant competition for scarce resources (capital and labour).
- There will be strong competition between jurisdictions in getting assets and projects to market.
- The infrastructure project activity will pick up slack in the construction labour market created by the maturing mining and resource sector investment cycle.

R&D

Cuts to R&D incentives

The tax offset for the R&D incentive will be cut by 1.5 percentage points, effective from 1 July 2014. As proposed company tax cuts take effect later, the relative tax saving from the R&D offset will be lower in fiscal 2015.

The current refundable tax offset of 45 percent for companies with global turnover of less than $20 million will fall to 43.5 percent. This offset will continue to be refundable for companies in tax losses.

For large companies, the non-refundable tax offset drops from its current rate of 40 percent to 38.5 percent.

This reduction matches the cut in the company tax rate (from 30 percent to 28.5 percent) which will apply from 1 July 2015. In addition, the Paid Parental Leave Scheme proposes to create a 1.5 percent levy for companies with taxable income over $5 million.

This shrinking in government support for self-directed innovation could stifle investment.

The Bill to exclude claimants with Australian assessable income over $20 billion will also be tabled before the Senate on 15 May 2014.

Finally, the Government is considering further R&D reforms through its White Paper.

Key insights

- The R&D Tax Incentive reduces, effective 1 July 2014.For large companies this represents a 15 percent drop from 10 cents in the R&D dollar to 8.5 cents.
- These changes are detrimental to encouraging innovation and contrast with other initiatives in the Budget encouraging Australian industry to innovate.

Grants

Re-focused support

The Government has abolished $845 million of industry support programs.

New funding initiatives focused on strengthening the overall business environment, building capability, driving innovation and productivity are good news for business.

The Government has found savings across a range of industry programs including cessation of the Australian Renewable Energy Agency ($1.3 billion) and the Ethanol Production Grants Program ($120 million net savings), modification of biodiesel tax treatment ($156 million net savings) and reduced funding for the Automotive Transformation Scheme ($618 million).

Whilst not targeted specifically at industry, other areas of significant new investment include the $20 billion Medical Research Future Fund, $1 billion to establish the National Landcare Initiative and $1 billion for a National Stronger Regions Fund.

Key industry focused announcements include:

$ million	Program	Description
2,550	Emissions Reduction Fund	Incentive based approach to support abatement activities across the economy
484	Entrepreneurs' Infrastructure Program	Supporting commercialisation, job creation and capability of small business
476	Industry Skills Fund	Supporting the training needs of small to medium enterprises
100	Growth Fund	Supporting new jobs, investment and economic growth in South Australia and Victoria following announcements by vehicle manufacturers
100	Exploration Development Incentive	Exploration credits, paid as a refundable tax offset, for greenfields mineral exploration
50	Manufacturing Transition Grants Program	Assist transition to higher value manufacturing activities

Key insights

- Government has refocused industry support programs. This creates opportunities for all companies.
- Announcements reflect transitional challenges facing the Australian economy and federal policy agendas.

Government and NCoA

About the NCoA

The much-anticipated report of the National Commission of Audit (NCoA), released on 1 May 2014, put forward 86 recommendations aimed at delivering $60-70 billion in savings a year by 2023-24.

In October 2013, the Treasurer Joe Hockey tasked the NCoA with reviewing the size and scope of government. Headed by Tony Shepherd AO, former President of the Business Council of Australia, the NCoA includes former Minister, Amanda Vanstone and former senior public servants, Peter Boxall AO, Tony Cole AO and Robert Fisher AM. The preparation of the report was supported by staff from the Departments of Finance, the Treasury, and Prime Minister and Cabinet.

The NCoA's recommendations were completed in two phases in February and March. There are 64 recommendations in the Phase 1 Report dealing with improving the sustainability of the nation's finances. The Phase 2 Report considers 22 recommendations around public sector performance and accountability as well as infrastructure.

The Government programs associated with the largest and fastest growing areas of Commonwealth spending were a major focus of the NCoA's report.

With the release of the Budget, we have the first indication of the Government's preparedness to take on the NCoA's recommendations.

Response to the NCoA

In a media release issued with the Budget, the Government set out its response to the NCoA report and acknowledged its importance as a critical input to the Budget preparation process.

The response highlights the many review programs the Government has underway.

This includes the Tax White Paper, Federation White Paper, the Financial Systems Inquiry, Productivity Commission Review of Childcare, First Principles Review of Defence and Mental Health Review.

"Our report was commissioned by the government and, as the elected government, it is its right and obligation to choose the reform path. Doing nothing is not an option and if there are three things I would like to see accepted as principles arising from our report, they would be:

- Adoption of new fiscal rules and disciplines and a plan that returns the budget to a sustainable surplus over the next 10 years
- Reform of the federation, including resolution of the vertical and horizontal fiscal imbalances, devolution to the states and giving the states improved funding sources so that they can be the masters of their own destiny
- A society where those who can look after themselves do so and those who cannot are supported and encouraged to contribute to society".

Tony Shepherd AO, Chair
NCoA
Australian Financial Review, 2 May 2014

The Government has also flagged its future focus on addressing many of the improvements to the business of government. This includes the digital and data efficiency improvement initiatives such as greater adoption of e-government, cloud computing and data analytics.

A major initiative announced is the development and implementation of a contestability framework to review government functions. To be administered by the Department of Finance, this work program will run over 3 years. These reviews will offer opportunities for identified functions to be delivered through alternative and contestable approaches.

The Government will fund the development of a market testing proposal to identify potential alternative approaches to the delivery of health payments.

Government and NCoA

Smaller government

The Government has adopted many of the NCoA's recommendations regarding reducing the number of government agencies, through privatisation, abolishment, mergers with other agencies or by consolidation into departments.

Scoping studies will be launched to consider the sale of Defence Housing Australia, the Royal Australian Mint, Australian Hearing and the Australian Security and Investment Commission's file registry.

The National Water Commission, Council of Australian Governments Reform Council and Australian Renewable Energy Agency are some of the more significant bodies to be abolished.

The Australian Customs and Border Protection Service will be merged with the Department of Immigration and Border Protection, and a new organisation, the Australian Border Force, will be formed. Various tribunals will be merged into a single body as will the government superannuation agencies. The corporate functions of the major cultural institutions housed in Canberra will also be merged.

The Government has also combined 150 Indigenous programs under the umbrella of the Indigenous Advancement Strategy which comprises five programs, with further reforms to be considered along with the Forrest Review.

This continues the reshaping of the public service that has been underway since the 2013 election to bring about 'smaller government'. However, this should be seen as a first phase with more changes expected.

"Around the world, there is a realisation that continuing to manage government activities in the same way will not achieve the step change required to protect public service provision into the future.

A different approach is required. One that encourages the development of a sustainable public sector economy supporting a wide range of delivery models and providers, and the market behaviours to better influence cost, quality and productivity outcomes.

By focusing on the public sector's core activities – regulation, policy and service delivery – contestability involves rethinking the role of government and shifting the public sector mindset from 'need to deliver' to 'responsible for outcome'.

We are seeing contestability frameworks being used to test government services to ensure the public is provided with the best possible outcomes at the best possible price and quality."

Michael Hiller
National Leader, Infrastructure, Government and Healthcare

Key insights

- There are new opportunities for those looking to fully engage with the public sector as government seeks to bring in 'outside' ideas, influences and expertise.
- The Government has not finished reshaping its operations, with the potential for many more significant changes to come.
- These changes are likely to bring a more commercial focus to government, from its buying arrangements through to use of technology and corporate services.
- Business also needs to rethink how it engages with government, particularly the ability to move more towards performance-based contracts.
- The opportunities to deliver services to government will increasingly include frontline services in addition to the traditional back office activities.

Government and NCoA

Main recommendations on governance and fiscal responsibility	Government Response
Surplus of 1 percent of GDP by 2023-24 and taxation below 24 percent of GDP (Rec 1)	The Government's fiscal strategy is in the Budget
Reporting of key budget information for 10 years (Rec 6)	Included in the Budget
Reform the Federation (Rec 7) Provide states with access to personal income tax through a surcharge (Rec 8) GST allocated to states on per capita basis (Rec 9)	Will be considered in the Federation White Paper
Government bodies reduced from 99 to 26 (Rec 50)	Initial reforms are in the Budget
Non-principal Government bodies reduced from 696 (Rec 14- Phase 2)	Initial reforms are in the Budget
Defence expenditure at 2 percent of GDP within a decade (Rec 24)	To be considered in the First Principles Review of Defence

Main recommendations on health, education, welfare and other assistance	
Linking eligibility to age pension at 77 percent of life expectancy for those born after 1965 (Rec 13) Age pension means testing (inc. principal residence with high threshold) (Rec 13)	Structural reforms commencing in 2017-18 Budget
Private health insurance in place of Medicare for high incomes and co-payments for health services (Rec 17)	Structural reforms to Health are in the Budget
Reduce Paid Parental Leave cap to Average Weekly Earnings, but retain 1.5 percent levy (Rec 21)	Rejected PPL cap of $100,000 income. The PPL will be implemented from 1 July 2015
Transfer funding and policy to states (Rec 23)	To be considered in the Federation White Paper
Family tax benefits consolidated with new single means test (Rec 20)	Structural changes in the Budget
Retain current National Disability Insurance Scheme proposals but slower phasing in (Rec 16)	National Disability Insurance Agency will determine optimal rollout
Increasing co-payments for pharmaceuticals(Rec 19)	Initial structural reforms to the Pharmaceutical Benefits Scheme are in the Budget

Main recommendations impacting business	
Reduce industry assistance for 22 current programs (Rec 32)	Reforms to Industry Assistance are in the Budget
Rationalise $22 billion spent on 500 grants (Rec 49)	Initial reforms are in the Budget
User road charging for heavy vehicles extending to universal charging over time (Rec 3–Phase2)	Road user charging reforms to be considered by Productivity Commission

Source: Media Release MC 46/14 - Our response to the National Commission of Audit report

Health

Over the last 2 years the health portfolio has been in the background when it comes to major initiatives. Focus has been on e-health and the introduction of more preventative care, but the change in funding has been relatively small.

Health has once again stepped into the limelight. The Government has reduced budgeted health expenditure by $7.9 billion over 2014-15 to 2017-18 through a combination of shifting costs to patients through co-payments and stopping funding altogether for some programs.

To compensate for the reduction in expenditure, the Government has announced a substantial increase in medical research funding. It will establish a $20 billion Medical Research Future Fund from savings made within the health budget, which will provide $276.2 million in medical research funding by 2017-18, and $1.0 billion per year from 2022-23. This will put Australia on the path to becoming a world leader in this field.

Major changes

The Government has outlined its intent to change primary health care in Australia. Medicare Locals will be abolished and replaced by Primary Health Networks with Clinical Councils. There will be no impact on the budget.

The Government will introduce a minimum $7 co-payment for general practitioner, pathology and diagnostic imaging services, with a safety net for concession card holders and children under 16 years of age.

A Low Gap Incentive will be paid to providers where the minimum co-contribution is charged. There are also additional co-payments for pharmaceuticals.

The focus on a more 'user pay' arrangement challenges the notion of the universal health insurance scheme known as Medicare.

Out of pocket funding has already grown rapidly compared to total primary health care expenditure. According to the Australian Institute of Health and Welfare, it increased from $12.9 billion in 2006-07 to $17.2 billion in 2011-12. These co-payment arrangements will increase growth even further.

Other major changes to the health budget are listed below.

- Ceasing hospital funding guarantees and changing index arrangements for federal hospital funding will save $1.8 billion over 2014-15 to 2017-18.
- A reduction in Medicare Benefits Schedule (MBS) Rebates from 1 July 2015 will save $3.5 billion over 5 years.
- Pausing indexation of some MBS fees for two years from 1 July 2014 and the Medicare Levy Surcharge and Private Health Insurance Rebate thresholds for 3 years from 1 July 2015 will save $1.7 billion over 5 years.
- An increase in co-payments for Pharmaceutical Benefits Scheme and safety net thresholds from 1 January 2015 will save $1.3 billion over 2014-15 to 2017-18.
- A new Medicare Safety Net from 2015-16 will save $266.7 million over 5 years.

$ billion	2013-14	2014-15	2015-16	2016-17	2017-18
Health expenditure	64.5	66.9	68.2	71.8	74.9
Growth	3.6	3.7	2.0	5.3	4.3
% of total expenditure	**15.5**	**16.1**	**15.8**	**15.8**	**15.7**

Key insights

- Changes to the health budget signals the Government's desire to manage health expenditure by shifting costs to patients through additional co-payments and reducing demand for primary care services through the greater use of price signals.
- A reduction in GP consultations due to co-payments will reduce the demand for other primary health care services, such as pathology, diagnostic imaging and specialists.
- These primary care providers will also experience a reduction in MBS rebates, with the opportunity to claw back revenue through co-payments.
- A reduction in the use of primary health care services could lead to worse health outcomes for some people, and shift the cost of their care into the hospital sector. This could put further pressure on State and Territory health budgets and greater reliance on private hospitals.

Disability & aged care

DisabilityCare

On 21 March 2013 the National Disability Insurance Scheme (NDIS) Bill passed through Parliament.

Since then, governments have been transitioning towards full implementation. In the 2012-13 Budget, $1.0 billion was allocated to fund launch sites in six locations to start on 1 July 2014.

Launch was subsequently pushed forward 1 year, with four launch sites established in the last year, with the remaining two due to start on 1 July 2014.

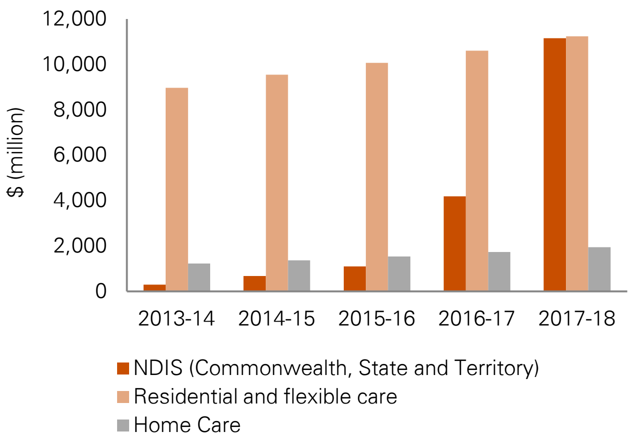
The NDIS represents a significant change to the way disability support is funded and delivered. To cover part of the cost, the Medicare Levy will increase from 1.5 percent to 2.0 percent of taxable income from 1 July 2014.

Changes in this Budget

Expenditure for the NDIS is projected to be $17.4 billion over the forward estimates. Of this, the Government will contribute $8.4 billion with the remainder paid for by the States and Territories.

There has been no change to the National Disability Insurance Scheme within the Budget, with the Government reaffirming its support for the Scheme. An optimal roll-out plan will be released by the National Disability Insurance Agency in the near future.

Expenditure



Aged care

The most significant reforms the aged care sector has seen in over 15 years will start on the 1 July 2014. This includes a substantial increase in the number of Home Care packages, the delivery of Consumer Directed Care, changes to accommodation payment arrangements, and the inclusion of additional income and asset tests.

The Government is aware of the expected increase in the cost of aged care on future budgets. Government real expenditure on aged care services was $13.6 billion in 2012-13, and has averaged an annual real growth rate of 5.5 percent since 2005-06.

Changes in this Budget

Aged care related services will experience a large decrease in funding for some programs.

By reducing the rate of real growth in the Commonwealth Home Support Program from 1 July 2018, the Government projects savings of $1.7 billion over 6 years.

More immediately, the Government will cease the Aged Care Payroll Tax Supplement, saving $652.7 million over 2014-15 to 2017-18. This will reduce revenue for residential care providers at a time of uncertainty associated with the reforms.

The government will reprioritise $1.5 billion in funding over 5 years by increasing aged care subsidies by 2.4 percent in home care, residential care and community programmes on 1 July 2014.

This funding was initially removed from the sector to develop a Workforce Compact, which has since been abolished.

The Government will also bring forward the allocation of home care places. This will have no impact on the budget.

Key insights

- Removing the Aged Care Payroll Tax Supplement will reduce provider revenue. Some providers will be compensated by an expected increase in revenue from the Government removing pricing caps on high care resident accommodation from 1 July 2014.
- Bringing forward the allocation of home care packages will suit some providers. However, the home care sector is going through major change with the introduction of consumer directed care and many providers will not be ready to deliver additional home care packages.

Education

The Federal Budget will reduce total funding to education by $3.7 billion over the 4 years to 2018.Of these reductions, $3.2 billion in savings arise from a reduction in income thresholds and indexation under the Higher Education Loan Programme.

The key reforms to higher education include:

- Allowing private operators and non-Universities access to Commonwealth Student Grants for the provision of higher education studies.
- Allowing Universities the freedom to price their programs in the market as they see fit.
- Extending the demand driven system to sub-bachelor higher education courses.
- Establishing a commonwealth scholarship scheme that will require Universities to set aside 20 percent of their fee income for scholarship reimbursements at their Universities.

The level of Commonwealth Student Grants will be reduced by an average of 20 percent from January 2016 and changes to the interest payable on HECS will increase from CPI to the interest rate payable on the government bond market.

The Government also announced its continued funding of the National Collaborative Research Infrastructure Strategy (NCRIS) beyond June 2015 as well as funding for specific research undertakings which included research into dementia and juvenile diabetes.

Key insights

- Greater autonomy will drive greater competition and innovation, and provide students with much greater choice.
- Universities will need greater sophistication in their marketing and a deeper understanding of the future student customer base to remain competitive.
- Scholarship programs should help to improve access to education.

Defence

The Government has reaffirmed its 2013 election policy pledge to increase Defence spending to the equivalent of two per cent of GDP over the course of the decade.

Savings of $1.2 billion over 4 years in the Defence Portfolio have been identified through initiatives to increase efficiency, reduce spending in lower priority areas and defer lower priority projects. This includes a reduction of 1200 Australian Public Service staff over 4 years.

These savings will be retained for re-investment in Defence capability, resulting in no impact on overall Defence funding.

More fundamental Defence reforms recommended in the recent NCoA will be further considered in the First Principles Review of Defence.

Importantly for Defence industry, the Government has flagged its intention to achieve alignment between the 2015 Defence White Paper and a "fully-funded" Defence Capability Plan which will provide much needed stability to the acquisition process and industry planning.

Other highlights include the reintroduction of the ADF Gap Year for young Australians to experience a year in the Army, Navy or Air Force and the introduction of new military superannuation scheme arrangements.

Key insights

- The Government highlights the need to draw heavily on private sector expertise in order to successfully deliver the Future Submarine Program which is in its critical early phase and is likely to become Australia's largest ever defence project.
- The Government has agreed to Defence retaining the proceeds of sales of surplus Defence property which increases the likelihood of major property divestment and will present opportunities to invest in new capabilities including infrastructure.

Direct Action Plan

The Direct Action Plan (DAP), and its centrepiece policy, the Emissions Reduction Fund (ERF) is designed to meet the Government's commitment to reduce Australia's greenhouse gas emissions by 5 percent (on year 2000 levels) by 2020, at the lowest cost. The ERF and "safeguard" mechanism will enable industry to sell carbon abatement back to the Government while acting as a mechanism to deter companies from exceeding historical emissions levels. The ERF is scheduled to commence on 1 July 2014, with the safeguard mechanism commencing one year later.

The Budget commits a total of $2.55 billion to the ERF, over the forward estimate. An additional $729.8 million is allocated over the first 3 years, from July 2014, compared to the Green Paper commitment of $1.55 billion over the same time period. Through to 2020, the Government will purchase 421 million tonnes CO2-e from industry generated offsets.

The timing of the transition from the existing Carbon Pricing Mechanism (CPM) to the DAP will likely impact Australian businesses in a number of areas, including financial accounting and reporting for the 2014 and 2015 financial years, and the potential necessity to remove the carbon costs charged for goods and services.

Replacing Australia's CPM creates a unique problem for businesses that have already invested in emission abatement - as has already occurred, for example, in the underground coal mining and the landfill sector with their installation of sophisticated systems that capture and generate energy from fugitive methane. Operators of existing abatement projects seem likely to be ruled out of bidding this abatement into the ERF.

The proposed approach to the setting of emission baselines is based upon absolute direct emissions over a historical period, defined at a facility level. The implication of this proposal approach is that facilities that do not have access to financial support through the ERF may be able to simply abandon the abatement project provided that the resulting emissions do not exceed the pre-project levels.

Additional carbon-related budget announcements include:

- Abolition of the Australian Renewable Energy Agency (ARENA), saving $1.3 billion over 5 years from 2017-18 (funding of $1 billion over 7 years will remain in place to support existing priority projects).
- Reduction in funding of $459.3 million of the Carbon Capture and Storage Flagships program from 2017-18 (funding of $191.7 million over 7 years will remain available to support existing projects).
- Reduction in funding of $16.8 million of the National Low Emissions Coal Initiative over 2 years from 2013-14 (funding of 96.6 million over 4 years will remain in place).
- $68.5 million of additional funding for the ACCC over 4 years from 2014-15 to fund its operation and to assist in the monitoring and protection of consumer interests in relation to repeal of the carbon tax.

Key insights

- Your business may face a range of regulatory impacts resulting from new and potentially complex policies.
- There are several aspects of the Government's repeal of the Carbon Pricing Mechanism that may affect your business, including the repeal's timing and how this impacts financial accounting and reporting, and the difficulty of removing the price of carbon from goods and services.

"Australia's climate change policy is set to undergo fundamental changes over the next 6 to 18 months. The top three issues for business will be: the implications of the repeal and subsequent removal of the carbon price for financial accounting and regulatory compliance; the future viability and value of the investments in emission reductions made in response to the carbon price; the need to consider the opportunity to establish emission reduction projects."

Adrian King
National Leader, Climate Change & Sustainability

Overview of changes

The main changes in revenue and expenditure for 2014-15 and from 2015 to 2018 as outlined in the budget papers.

Change in revenue top 10

$ million	2014-15	2015-18
Temporary Budget Repair Levy	600.0	2,500.0
Reintroduction of fuel excise indexation	167.5	2,050.0
Abolish the Mature Age Worker Tax Offset	0	760.0
Korea-Australia Free Trade Agreement	(100.0)	(535.9)
R&D tax incentive — reducing the tax offset rates	70.0	550.0
Restoring integrity in the Australian tax system	(12.1)	(347.3)
Abolish the Dependent Spouse Tax Offset	0	320.0
Australian Reinsurance Pool Corporation — future options	36.3	187.5
Repeal of MRRT - change to superannuation guarantee schedule	(170.0)	260.0
Australian Transaction Reports and Analysis Centre — industry contribution	9.9	69.0
Other	118.5	2,146.7
Total – Increase	**720.1**	**7,960.0**

Change in expenditure top 10

$ million	2014-15	2015-18
Official Development Assistance — reprioritised funding	(601.3)	(6,432.3)
Infrastructure Growth Package — Asset Recycling Initiative	335.0	3,570.0
Medicare Benefits Schedule — patient contributions	8.8	(3,484.0)
HELP — repayment thresholds and indexation	(334.4)	(2,820.4)
Infrastructure Growth Package — new investments	201.7	2,498.8
Family Payment Reform — maintain FTB payment rates for 2 years	(397.3)	(2,202.6)
Family Payment Reform — limit FTB Part B to families with children under six	17.1	(1,906.8)
Commonwealth Public Hospitals — change to funding arrangements	(217.3)	(1,556.7)
Pausing indexation - Medicare related items and Private Health Insurance Rebate	(141.6)	(1,533.2)
Maintain eligibility thresholds for government payments	(160.9)	(1,318.3)
Other	(649.2)	(12,238.9)
Total – (Reduction)	**(1,939.4)**	**(27,424.4)**

The Government's proposed company tax cut to 28.5 percent, the Paid Parental Leave Levy of 1.5 percent and the Paid Parental Leave scheme have not been costed in the Budget but are being provided for in the Contingency Reserve.

CFO / Tax checklist

1	Changes in tax rates • deferred tax accounting impacts • dividend franking planning • consequential R&D offset reduction	☐
2	Paid parental leave scheme • employer, employee and financial impacts	☐
3	Fringe benefits tax rate increase • remuneration cost impacts and new opportunities	☐
4	Industry assistance cuts • financial impacts	☐
5	Backlog of unenacted tax measures • tax compliance and tax accounting impacts	☐
6	Reforms to Tax and Federation • engagement strategy	☐
7	Proposed changes to corporations law and dividends • directors duties, constitution • accounting and tax impacts	☐
8	Government and NCoA response • new service opportunities from smaller government • changes to government dealings	☐
9	Employment initiatives • Incentive for hiring older workers ($10,000)	☐
10	Deferral of income tax measures • offshore banking units • managed investment trusts • third party reporting to the ATO	☐
11	Infrastructure • capital / funding challenges	☐
12	Reduced thin capitalisation safe harbours • re-evaluate capital funding • consider revaluing assets or alternate tests	☐
13	Base Erosion & Profit Shifting • new tax transparency regime – explain tax narrative to the market • review structures (hybrids and tax treaties)	☐
14	Distribution from foreign subsidiaries • reconsider existing equity / debt instruments	☐

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May 2014