May 2011

WS

Financial Consulting

Federal Budget 2011

Snapshot

The Federal Budget has delivered little in the way of surprises. Against a backdrop of recent media chat about cuts and tough budgets, many measures were well publicised in the run-up to Treasurer Wayne Swan's fourth Budget. And, as for toughness, it will be reasonably benign in 2011–2012, with many cuts set to take effect in following years.

The Budget focus is on increasing workforce participation, development of regional areas, and improving mental health services. And returning the Budget to surplus by 2012–13.

In the words of the Treasurer, the purpose of this Budget is "to put the opportunities that flow from a strong economy within reach of more Australians". We now have a "patchwork economy", he says; the Budget aims to get more people into work "and to train them for more rewarding jobs" so that "prosperity reaches more lives in more corners" of the country.

To bring the Budget back into surplus by 2012–13, the government has signalled spending cuts of $22 billion.

$1.5 billion in new initiatives were announced for mental health

Snapshot

The Economy

The main thrust of the Budget continues to be the goal of returning to surplus in 2012–13, "on time, as promised". But before that modest surplus of $3.5 billion (0.2 per cent of the economy) can be achieved, there will be some pain. This year, 2010–11, the deficit will blow out to $49.4 billion, $8.6 billion more than predicted in last year's Budget, and in 2011–12 it will still be $22.6 billion in the red.

Much of the blow-out is on the back of the overhang from the global financial crisis and the natural disasters which in the last 12 months damaged the economies of several states and two key trading partners. The impact is being felt in a sharp decline in tax receipts, down $16 billion in two years.

But even with a deficit of $22.6 billion in 2011–12, net debt will only be 7.2 per cent of GDP and negligible when compared with the US or major European economies.

Natural disasters have taken their toll on Australia's economy with annual growth falling to 2.25 per cent in 2010–11. But the Budget papers expect economic growth to reach 4 per cent in 2011–12 and still be a robust 3.75 per cent in 2012–13.

On the jobs front, unemployment is predicted to be around 4.5 per cent by mid 2013 with the creation of a further 500,000 jobs over the next two years.

The Budget at a glance

Workers for jobs

The feature of this year's Budget is increasing workforce participation. To quote the Treasurer: "We believe our economy can't afford to waste a single pair of capable hands." The jobs are there already; the pressure is on to find the workers.

A centrepiece plan has been announced to help industries obtain skilled workers and to modernise apprenticeships so that more Australians move into the workforce.

Under another aspect of this strategy, the effective tax rates for single parents will be cut by up to 20 cents in the dollar; $233 million will be invested in support programs to get the long-term unemployed back to work; and seniors claiming the work bonus can earn an extra $125 a week before pensions are affected.

Skilled migration will also play a major part in bolstering the workforce with 16,000 places earmarked for regional centres.

Tweaking taxation

While the last few budgets have delivered income tax cuts, this year's Budget chipped away at some provisions, to support low income earners and reduce tax breaks which some might tag as "middle class welfare".

For eligible workers, the Low Income Tax Offset (LITO) has been changed so that rather than 50 per cent of the offset being paid during the year and the balance included in tax refunds, 70 per cent will now be paid along the way, adding $6 a week for somebody earning $30,000 a year.

Another change has seen trustees lose the capacity to claim the LITO on funds paid from trusts to children aged under 18, which allowed children to earn $3,333 a year untaxed. The measure is expected to yield some $740 million.

Similarly the Dependent Spouse Tax Offset is being phased out for the under 40s. This move should deliver savings of $755 million. Family tax benefits have also been reduced, with the cut off age for eligible children moved from 24 to 21.

Supporting small business

Mindful of how some small businesses are doing it tough, particularly in light of the strong Australian dollar and the uneven economy, a number of financial incentives were announced.

Firstly, small businesses are set to benefit from the previously announced cut in the company tax rate to 28 per cent, effective from 2012–13. And to help with cash flow, tax instalment payments will be reduced by $700 million in 2011–12.

Fringe benefits tax also came under the spotlight with the introduction, for all new vehicle contracts, of a single rate of 20 per cent regardless of how far a car is driven. The new single rate is expected to save $954 million over five years.

The Budget also introduced an immediate $5,000 write off on the cost of a new work vehicle at a cost of $350 million.

Balancing this is the abolition of the Entrepreneurs Tax Offset which allowed small businesses with turnovers of less than $50,000 to claim a tax offset equal to 25 per cent of the income tax payable.

Boosting mental health

Health is a big winner in this year's Budget, particularly mental health and regional health services and infrastructure. $1.5 billion in new initiatives were announced for mental health, plus new funding for diagnostic imaging services and $1.8 billion for regional health facilities.

Building infrastructure

The Treasurer stressed the importance of infrastructure in his Budget speech, saying the Government was investing $36 billion in road, railways and ports in addition to the National Broadband Network.

The Budget also aims to lessen barriers to private investment by reducing the tax uncertainty that lengthy and complex projects face. This move is specifically aimed at encouraging superannuation fund investment in infrastructure.

Super adjustments

Deep in the Budget papers are a number of changes to superannuation, some expected, some not.

To bring the Budget back into surplus by 2012–13, the government has signalled spending cuts of $22 billion.

Snapshot

After much lobbying by interested parties, the Budget amends the penalty regime that applies to excess superannuation contributions. Under the changes, if you breach your concessional contribution cap by less than $10,000, the contribution can be refunded and you do not have to pay a penalty. However, this is a once-only concession so you cannot breach a second time without penalties, nor does the change apply to non-concessional contributions.

The pension drawdown relief has been extended for another year although it has been cut from a 50 per cent reduction to 25 per cent. Following the GFC, pension account holders were allowed to draw down half their minimum pensions so their balances could recover. In 2011–12 those aged 55 to 64, for instance, will only have to draw down a minimum 3 per cent of their pension, not the full 4 per cent minimum.

Self-managed super funds will be asked to pay an extra $30 a year in annual charges to help fund the Stronger Super initiatives. The increase from $150 to $180 will raise $48.6 million.

In addition, indexation of the Government's co-contribution of up to $1,000 for after-tax contributions to super for those earning less than $31,920 a year has been frozen.

Looking ahead

It is unlikely that this Budget, with its long-term objectives, will affect the Reserve Bank's view on whether to raise interest rates later this year — as some commentators say is likely.

However, by aiming to get back into surplus by 2012–13, and by targeting job skills and workforce participation, and strengthening infrastructure and opportunities in regional areas, the Budget goes some way to removing the pressure points likely to push up wages and inflation — both spurred on by booming commodity prices.

But the Budget is only one piece in the puzzle. The next part of the financial and economic jigsaw will come in a few months when the government makes its announcements about carbon pricing.

WS
Financial Consulting

Rick Maggi
Westmount Securities Pty Ltd
40 Kings Park Road,
West Perth WA 6005

P 08 9322 7699
F 08 9481 4551
E rickmaggi@westmount.com.au
W www.westmount.com.au