Westmount Financial

Federal Budget 2020:
What it means for you...

As widely anticipated, the announcement included bringing forward personal income tax cuts already legislated. Together, these changes deliver tax relief to low- and middle-income earners for the 2020-21 income year of up to $2,745 for individuals and up to $5,490 for dual income families.

The Treasurer also announced a range of taxation benefits for small and medium businesses, intended to stimulate the business sector leading to jobs growth.

This summary provides coverage of the key issues of most interest to you.

Highlights

- Immediate personal tax relief for individuals
- Exempting granny flat arrangements from capital gains tax
- Extension of the provision allowing small business to instantly write-off asset purchases
- Temporary loss carry-back to support cash flow
- Covid-19 response package – Victorian Government grants
- JobMaker hiring credit
- Superannuation reform
- Covid-19 response package – further economic support payments

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Personal income tax

The Government will bring forward the second stage of its Personal Income Tax Plan by two years to 1 July 2020 while retaining the low and middle income tax offset (LAMITO) for 2020-21. The changes will provide immediate tax relief to individuals and support the economic recovery and jobs by boosting consumption.

Bringing forward the second stage of the Personal Income Tax Plan

The following changes have been announced:

- The top threshold of the 19 per cent personal income tax bracket will increase from $37,000 to $45,000.
- The low income tax offset (LITO) will increase from $445 to $700. The increased LITO will be withdrawn at a rate of 5 cents per dollar between taxable incomes of $37,500 and $45,000. The LITO will then be withdrawn at a rate of 1.5 cents per dollar between taxable incomes of $45,000 and $66,667.
- The top threshold of the 32.5 per cent personal income tax bracket will increase from $90,000 to $120,000.

Taxable income	Stage 2: Tax payable[1] (residents)
Up to $18,200	Nil
$18,201 - $45,000	Nil + 19%
$45,001 - $120,000	$5,092 + 32.5%
120,001 - $180,000	$29,467 + 37%
Above $180,000	$51,667 + 45%

Supporting Older Australians — exempting granny flat arrangements from capital gains tax

The Government will provide a targeted capital gains tax (CGT) exemption for granny flat arrangements where there is a formal written agreement. The exemption will apply to arrangements with older Australians or those with a disability. The measure will have effect from the first income year after the date of Royal Assent of the enabling legislation.

CGT consequences are currently an impediment to the creation of formal and legally enforceable granny flat arrangements. When faced with a potentially significant CGT liability, families often opt for informal arrangements, which can lead to financial abuse and exploitation in the event that the family relationship breaks down. This measure will remove the CGT impediments, reducing the risk of abuse to vulnerable Australians.

[1]Plus Medicare levy.

Business owners

Temporary full expensing to support investment and jobs

The Government will support businesses with aggregated annual turnover of less than $5 billion by enabling them to deduct the full cost of eligible capital assets acquired from 7:30pm AEDT on 6 October 2020 (Budget night) and first used or installed by 30 June 2022. It will improve cash flow for qualifying businesses that purchase eligible assets and bring forward new investment to support the economic recovery.

Full expensing in the year of first use will apply to new depreciable assets and the cost of improvements to existing eligible assets. For small and medium sized businesses (with aggregated annual turnover of less than $50 million), full expensing also applies to second-hand assets.

Temporary loss carry-back to support cash flow

The Government will allow eligible companies to carry back tax losses from the 2019-20, 2020-21 or 2021-22 income years to offset previously taxed profits in 2018-19 or later income years.

Corporate tax entities with an aggregated turnover of less than $5 billion can apply tax losses against taxed profits in a previous year, generating a refundable tax offset in the year in which the loss is made. The tax refund would be limited by requiring that the amount carried back is not more than the earlier taxed profits and that the carry back does not generate a franking account deficit. The tax refund will be available on election by eligible businesses when they lodge their 2020-21 and 2021-22 tax returns.

Currently, companies are required to carry losses forward to offset profits in future years. Companies that do not elect to carry back losses under this measure can still carry losses forward as normal.

COVID-19 Response Package — making Victoria's business support grants non-assessable, non-exempt income for tax purposes

The Government will make the Victorian Government's business support grants for small and medium business as announced on 13 September 2020 non-assessable, non-exempt (NANE) income for tax purposes.

State-based grants such as the Business Support Grants are generally considered taxable income by the Commonwealth. Given COVID-19 and the exceptional circumstances Victorian businesses face, providing this additional concessional treatment will assist in their recovery.

The Commonwealth will extend this arrangement to all States and Territories on an application basis. Eligibility would be restricted to future grants program announcements for small and medium businesses facing similar circumstances to Victorian businesses.

The Government will introduce a new power in the income tax laws to make regulations to ensure that specified state and territory COVID-19 business support grant payments are NANE income.

Eligibility for this treatment will be limited to grants announced on or after 13 September 2020 and for payments made between 13 September 2020 and 30 June 2021.

JobMaker Hiring Credit

The Government will provide $4.0 billion over three years from 2020-21 to accelerate employment growth by supporting organisations to take on additional employees through a hiring credit. The JobMaker Hiring Credit will be available to eligible employers over 12 months from 7 October 2020 for each additional new job they create for an eligible employee.

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Eligible employers who can demonstrate that the new employee will increase overall employee headcount and payroll will receive $200 per week if they hire an eligible employee aged 16 to 29 years or $100 per week if they hire an eligible employee aged 30 to 35 years. The JobMaker Hiring Credit will be available for up to 12 months from the date of employment of the eligible employee with a maximum amount of $10,400 per additional new position created.

To be eligible, the employee will need to have worked for a minimum of 20 hours per week, averaged over a quarter, and received 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.

Superannuation

Superannuation Reform

The Government will provide $159.6 million over four years from 2020-21 to implement reforms to superannuation to improve outcomes for superannuation fund members. The reforms, which will reduce the number of duplicate accounts held by employees as a result of changes in employment and prevent new members joining underperforming funds, include:

- the Australian Taxation Office will develop systems so that new employees will be able to select a superannuation product from a table of MySuper products through the YourSuper portal
- an existing superannuation account will be 'stapled' to a member to avoid the creation of a new account when that person changes their employment. Future enhancements will enable payroll software developers to build systems to simplify the process of selecting a superannuation product for both employees and employers through automated provision of information to employers
- from July 2021 the Australian Prudential Regulation Authority will conduct benchmarking tests on the net investment performance of MySuper products, with products that have underperformed over two consecutive annual tests prohibited from receiving new members until a further annual test that shows they are no longer underperforming.

Social security

COVID-19 Response Package — further economic support payments

The Government will provide $2.6 billion over three years from 2020-21 to provide two separate $250 economic support payments, to be made from November 2020 and early 2021 to eligible recipients and health care card holders. These payments are exempt from taxation and will not count as income support for the purposes of any income support payment.

Federal Budget 2020:

What it means for the market...

Macquarie Bank review the Australian Federal Government's 2020/21 budget and assess its implications for the Australian financial markets.

The table below highlights the key budget forecasts and changes since the July Economic and Fiscal Outlook (JEFU).

Budget forecast changes...

	JEFU forecasts 2020/21	Budget forecasts 2020/21	Direction change
Underlying cash balance ($b)	**-$184.5**	-$213.7	⬇
Underlying cash balance (% GDP)	**-9.7%**	-11.0%	⬇
Net debt ($b)	**$644**	$703	⬆
Net debt (% GDP)	**35.7%**	36.1%	⬆
Real GDP	**-2.5%**	-1.50%	⬆
Household consumption	**-1.25%**	-1.50%	⬇
Business investment	**-12.5%**	-9.5%	⬆
Public demand	**4.5%**	5.75%	⬆
Private demand	**-4.0%**	-3.50%	⬆
Dwelling investment	**-16%**	-11%	⬆
Unemployment	**8.75%**	7.25%	⬇
CPI	**1.25%**	1.75%	⬆
Wages	**1.25%**	1.25%	➡
Major trading partners growth	**5.50%**	5.75%	⬆
AUDUSD	**$0.69**	$0.72	⬆
TWI	**60**	62	⬆
Iron ore (US$/t)	**$55**	$55	➡
Metallurgical coal (US$/t)	**$110**	$108	⬇
Thermal coal (US$/t)	**$54**	51	⬇

Source: Treasury, MWM Research, October 2020

Key highlights

- The delayed 2020/21 Federal budget is the most significant in decades. The aim is that it will go down in history as the budget that lifted Australia's economy out of recession via a government-backed jobs recovery.

- The overriding thrust of the budget is about transitioning the economy off unsustainable welfare payments (JobKeeper) via a heavy emphasis on policies that support job creation (JobMaker).

- The budget shows a continuation of the willingness of government to support the economy through this transition. In combination with emergency monetary policy settings, the combination of expansionary fiscal policy provides an unparalleled level of policy stimulus for the Australian economy.

- Debt levels are set to increase significantly but this as unavoidable and a necessary response given the size of the economic hit and the ongoing headwinds that this has created.

- This is a very positive budget which should be greeted with enthusiasm despite the depth of the problems it seeks to address. The Government has shown a clear willingness to kick-start the recovery while putting aside concerns about soaring debt levels. We think this is the right approach and treads a line between balancing short versus long term objectives.

- We think investors should welcome this pro-growth budget which addresses 'fiscal cliff' concerns, pulls forward tax-cuts and looks to turbo-charge the recovery via job creation. In combination with record low borrowing rates and forward guidance provided by the RBA, we think policy makers have not lacked in their willingness nor the level of policy support to get the economy back to a self-sustaining level as quickly as possible.

Budget winners and losers:

Winners…

Low/Middle income earners – pull forward second stage of Personal Income Tax Plan, retain low and middle income tax offset (LAMITO).

Businesses – heavily incentivised to hire younger staff (JobMaker, apprenticeships), cash flow boost from instant asset write-offs and $2b for R&D Tax Incentive.

Property – expansion of the First Home Loan Deposit Scheme (FHLDS) and CGT relief for granny flats.

Infrastructure – $10b in funds available to the states, focus on 'shovel-ready' projects (roads, councils).

Losers…

High income earners – tax relief remains long-dated (2024) with no pull forward as initially speculated.

Welfare – the transition away from JobKeeper will be difficult for those that may not have a job to return to when the program expires in March 2021.

Superannuation reforms – increased regulation for super sector with a greater focus on transparency, fees and underperforming funds. Expect ongoing industry consolidation.

Mega-caps – Businesses with annual turnover >$5b will miss out on support measures.

This was an extraordinary budget for extraordinary times. The Australian economy has been on life-support since COVID-19 hit the global economy in 1Q20 but now needs a major kickstart to get going again. The Federal Government has successfully minimised the downturn and is now looking to maximise the upturn via a range of growth-positive initiatives we review below…

Tax cuts

Middle income earners are the big winners here in a well telegraphed move that will see already legislated tax cuts pulled forward from 2022 and backdated to July 2020. The 19% tax bracket will increase from $37,000 to $45,000 while the 32.5% tax bracket will increase from $90,000 to $`120,000.

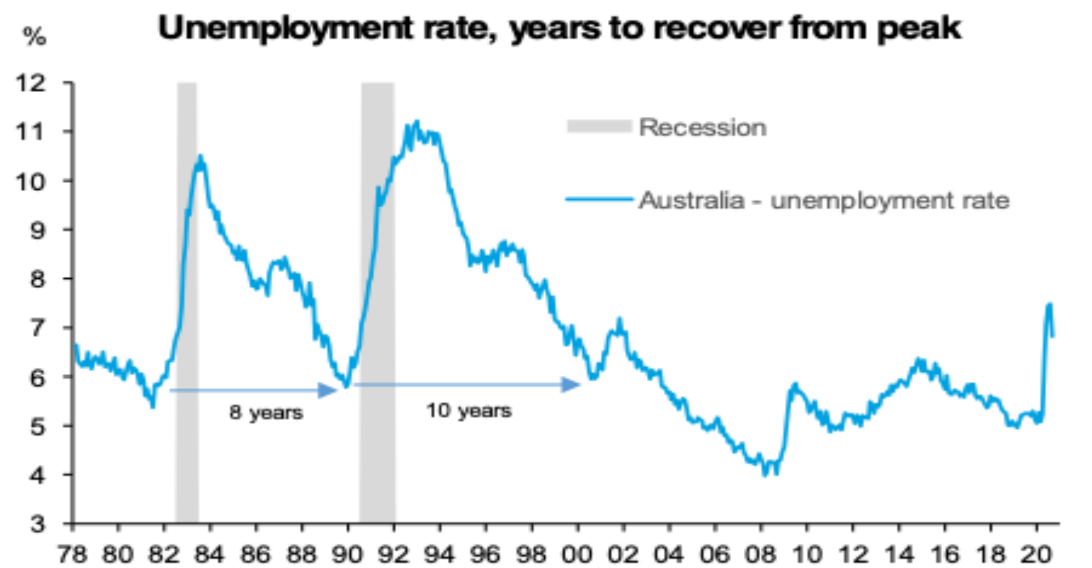
Tax cuts would typically be available from the beginning of the next financial year, but these are not typical times. Injecting cash into the economy is the top priority with tax cuts to 'go live' as soon as December, just in time for the holiday season. Similarly, welfare recipients will receive two $250 cash handouts to be paid in December 2020 and March 2021 which is highly likely to be spent quickly and support consumption.

High-income earners will need to wait till 2024 which we view as pragmatic given the higher likelihood these tax cuts are saved and the political opposition to this third round of tax relief.

Employment

History suggests the employment recovery following recessions can be long and arduous. It took eight years in the 1980's to drag unemployment back to pre-recession levels of ~6% while the 1990's took even longer. The recent experience has not been any better with unemployment in the last decade averaging well above pre-GFC levels.

Budget to drive a strong jobs recovery



Source: ABS, MWM Research, October 2020

The 2020-21 budget measures are designed to avoid this drawn out improvement with a much quicker government backed recovery via:

- **JobMaker Hiring Credit** of up to $200 per week will be available to employers hiring younger workers in the next 12 months. Available immediately and expected to support ~450k jobs at a cost of $4b. Importantly, the JobMaker Hiring Credit is designed to support new employment. Employers do not need to satisfy a fall in turnover test as they did with JobKeeper.

- **Boosting Apprenticeships Wage Subsidy** – employers will be paid a 50% wage subsidy, capped at $7k/quarter, for hiring apprentices and trainees. Available to businesses of all sizes it is expected to support up to 100k new jobs at a cost of $1.2b.

- **JobTrainer fund** – focus on upskilling workers with a $1b fund to support ~340k free or low-fee training places in areas of need.

- **Temporary full expensing** – allows for the deduction of the full cost of eligible depreciable assets of any value in the year they are first used or installed. Available immediately through to 30 June 2022 at a cost of $27bn over next 4 years.

- **Temporary loss carry-back** – permits the offset of tax losses against previous profits on which tax has been paid to generate a refund from now until FY22 at a cost of $5bn over next 4 years.

Business is arguably the big winner from this budget. We expect businesses will respond with force given the range of incentives announced. Youth employment is likely to now recover quicker than expected, which should in turn help consumption, while the almost uncapped nature of the asset write-offs should see demand surge for capital equipment. While unemployment may not yet have peaked (JobKeeper yet to roll off), it is clear these measures will be very supportive for jobs growth and stimulating demand through the economy.

While the Reserve Bank of Australia (RBA) held back on policy changes at its October meeting, we note its policy settings are increasingly tied to employment. The Bank now views "addressing the high rate of unemployment as an important national priority" and "will not increase the cash rate target until progress is being made towards full employment".

Macquarie's economics team expects the RBA to deliver further easing at its November meeting by reducing the 3-year bond yield target and rate paid on borrowing from the Term Funding Facility from 0.25% to 0.10%. The RBA is also likely to announce purchases of 5-10 year bonds which would flatten the yield curve and less upward pressure on the A$.

We think the combined effects of monetary policy (no rate hikes till progress towards full employment) and fiscal policy (stimulatory while unemployment >6%) should prove a powerful combination in generating a jobs recovery.

Housing

The popular **First Home Loan Deposit Scheme (FHLDS)** will be expanded. The scheme allows first home buyers to purchase a new home with a deposit as low as 5%, without paying lenders mortgage insurance. The FHLDS has helped those with low deposits (<20%) enter the housing market while also supporting the construction industry.

The FHLDS has proved extremely popular with the first two rounds of 10,000 places (20,000 total) allocated within months. The second round of the FHLDS, which only launched on 1 July 2020, has already seen many of the approved lenders reach their full allocations.

A further 10,000 places will now be allocated for the 2020-21 financial year. The price cap will also be significantly increased which should see the scheme broaden out to new regions and postcodes.

First Home Loan Price Caps receive boost

State/Territory	Previous	New	Change
NSW	$700,000	$950,000	36%
VIC	$600,000	$850,000	42%
QLD	$475,000	$650,000	37%
WA	$400,000	$550,000	38%
SA	$400,000	$550,000	38%
TAS	$400,000	$550,000	38%
ACT	$500,000	$550,000	10%
NT	$375,000	$550,000	47%

Granny flats – capital gains tax (CGT) will no longer apply if building a granny flat for elderly Australians or those with disabilities. This should benefit houseowners with elderly relatives and provide further support for the construction industry.

Infrastructure

The Government will provide an additional $10b in funding towards projects over the next four years bringing total commitments for new and accelerated projects since the onset of the COVID-19 pandemic to $14b across the forward estimates. 'Shovel-ready' projects will be fast-tracked with funding provided for small scale road safety ($2b) and local roads and infrastructure ($1b).

Superannuation reforms

The superannuation sector was one of the few clear losers from this budget. The Government's "Your Future, Your Super" reforms are forecast to save Australians ~$18b over the next decade. Key areas of change include:

- A new superannuation account will no longer be created automatically a worker starts a new job. Instead, superannuation will be 'stapled' to the worker. Expected to save workers ~$3b over 10 years.

- Super funds will be subject to performance tests with a requirement to inform members of underperformance. Expected to save workers ~$11b over 10 years.

- Launch of YourSuper online website enabling easier comparison of fees and performance across super funds.

Further consolidation for the superannuation sector appears highly likely following these announcements. By extension we expect this is unwelcome news for active fund managers which will be subject to ongoing fee pressure and mandate losses.

Equity market implications

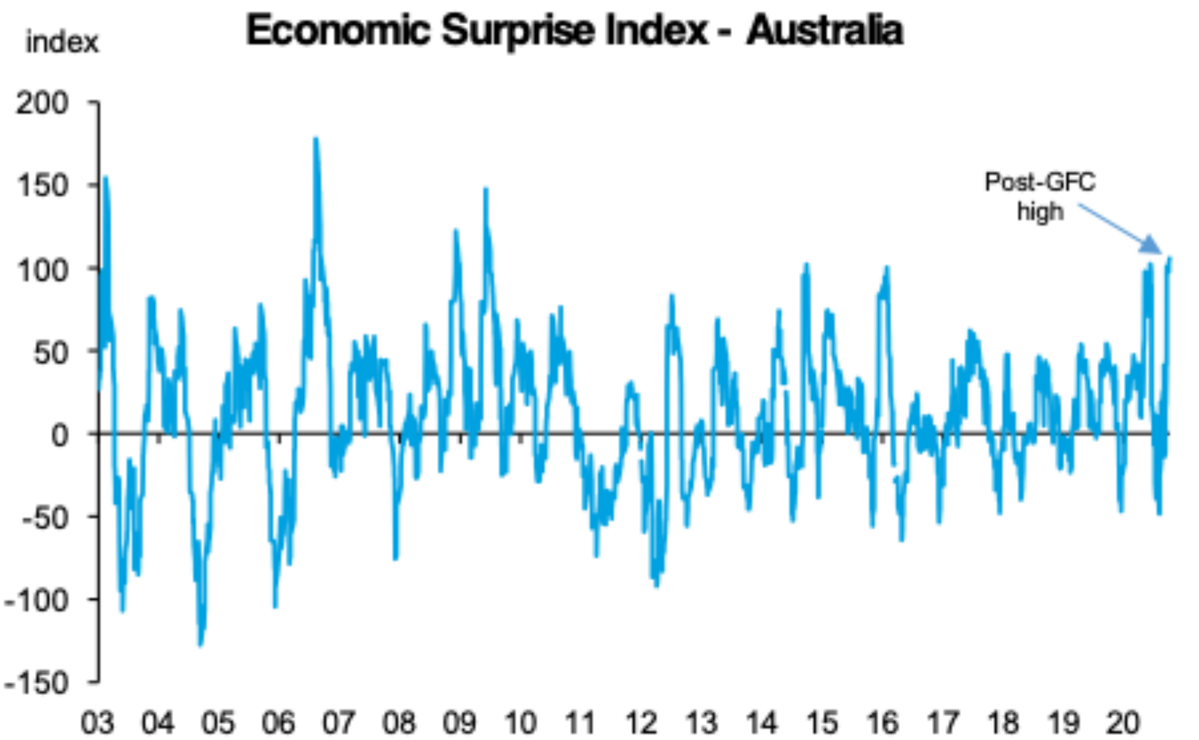
This was a historic budget by any measure. Most notably it marks a shift away from years of budget repair to a 'pro-growth' agenda. We think investors should take confidence from what is a clear plan to materially reduce unemployment from current levels, bolster the recovery via a suite of business incentives and ultimately lift the economy out of recession.

The recovery since March has strongly surprised to the upside reflecting both the extrapolation of current conditions by economists (too pessimistic) and the massive stimulus working its way through the economy. Unlike economic surprise indices in the US and Europe, which are showing clear signs of softening, Australia's has just hit a post-GFC high. We would not be surprised if this remains an ongoing theme (data beating expectations) in the months ahead as fiscal stimulus combined with an RBA Board prepared to fully utilize the tools at its disposal.

The economy is not the equity market and this is why the market is only around 10% off its YTD highs while the economy has fallen substantially. We think this budget will go a long way towards restoring both consumer and business confidence in respect of the backstopping from government.

This does not remove the pain that is now unavoidable in respect of further consumer delinquencies, weaker spending, rising unemployment and business solvencies. However, equities don't need strong growth to perform. They need rising profit margins alongside easy financial conditions and this backdrop does set the scene for this to eventuate – in time. We don't think investors could have asked for much more. Certainly this was not a budget that disappointed, but the hole is deep and hence regardless of the fiscal support, it will not be a v-shaped rebound from this point forward.

Recovery to take a leg-up



We highlight the major sector impacts below:

Consumer

Tax cuts and welfare payments have been designed to be spent as quickly as possible and consumer-linked sectors are the obvious beneficiaries. The retail sector is already benefiting from the work from home boom and existing stimulus but the budget measures (tax cuts, asset write-offs) should support consumer spending through the Christmas period and see a broadening out of expenditure to businesses for larger items e.g. machinery, vehicles.

We view domestic travel as a beneficiary from tax cuts, particularly while international borders remain closed. With retail already undergoing a massive boom for consumer durables (home offices, furniture, washing machines etc), which don't require frequent replacing, travel is likely to provide the larger delta within the consumer sector. Significant pent-up demand, lifting of restrictions, tax relief and international border closures should all prove supportive.

Infrastructure and Building materials

The domestic building materials and infrastructure sectors should welcome a renewed focus on spending initiatives within the budget. infrastructure spending and construction. For infrastructure exposure, Macquarie analysts have a preference to Seven Group (SVW), Downer (DOW) and Monadelphous (MND) while CSR Ltd (CSR) is preferred for exposure to the detached housing cycle.