The 2020-21 mid-year economic and fiscal outlook

A review of the major implications for business

December 2020

KPMG.com.au

Contents

Introduction 3
Economic overview and analysis 4
The flattened curve 5
Individuals 6
Corporate income tax 7
Enterprise 8
Contact us 9

Introduction

Signs of improvement in federal finances.

The federal government's mid-year economic and fiscal outlook ("MYEFO") documents show some improvement in the federal finances in just the two months since the 2020-21 Budget, including the prospect that the Australian economy will indeed grow, by 0.75 percent, in 2020-21.

In addition, Treasury forecasts that the underlying cash balance for 2020-21 will be a deficit of $197.7 billion, an improvement of $15.9 billion since this year's Budget.

Federal government net debt is not estimated to grow to beyond 43 per cent of gross domestic product (GDP) between now and a peak in 2023-24. This is a much more sustainable position than is the case in several other highly developed economies.

The expectation that 640,000 fewer employees are currently eligible for the JobKeeper subsidy than was forecast in the Budget is due to a combination of factors. These include better than expected employment growth, but also the impact of the narrowing of the eligibility criteria for businesses.

JobKeeper will continue to support many struggling businesses, and their workers, through to March 2021. By that time the wage subsidy will have cost around $90 billion. When one thinks of the speed with which it had to be implemented and the rapidly changing circumstances of the last nine months, JobKeeper represented an enormous challenge for the government and the Australian Taxation Office.

David Heathcote

National Managing Partner,
Deals, Tax & Legal

Grant Wardell-Johnson

Lead Tax Partner, KPMG
Economics & Tax Centre

Notwithstanding MYEFO's generally positive tone, unemployment is only expected to reduce to pre-pandemic levels by the middle of 2024. The extension of the Coronavirus Supplement and the relaxed eligibility criteria for income support recipients until 31 March 2021 are therefore welcome. As a society we will need to think through how we can best reduce the number of people who get left behind in the recovery process over the longer term.

We look forward to the 2021-22 budget and the possibility of further measures that will make it easier for people to take work when it is available. These could include support for the availability and affordability of child care services, which in our current social environment would particularly benefit women.

MYEFO's forecasts are predicated on there being only contained, localised outbreaks of COVID-19 in Australia, and on a widespread vaccination program having occurred before the end of 2021. We wish everyone the best of health during this time.

David Heathcote
National Managing Partner,
Deals, Tax & Legal

Grant Wardell-Johnson
Lead Tax Partner,
KPMG Economics & Tax Centre

Economic overview and analysis

The Treasurer's MYEFO statement today presents a rosier picture of Australia's path to economic recovery than what was presented only 10 weeks ago when he announced the 2020-21 budget.

Brendan Rynne

Chief Economist

Michael Malakellis

Principal Director,
KPMG Economics & Tax Centre

Even during this short period, we have witnessed the further containment of the coronavirus with very limited amounts of community spread, which has enabled the further lifting of restrictions and the broadening of economic activity across all industries, sectors and regions.

The improvement in the 'supply side' of the economy has been broadly matched by underlying demand, more so within the household consumption, but investment and government consumption have also positively contributed to the recovery. We have seen this play out in the labour market, where employment has risen by 270,000 since mid-September, with total employment now only about 1 percent lower than what it was prior to the commencement of the pandemic.

Economic growth for this financial year and the next is now forecast to be 0.75 percent and 3.5 percent respectively, revised from -1.5 percent and 4.75 percent. The pandemic-induced recession was driven fundamentally by a fall away in household consumption, and now this 'bounce' in economic activity is also being propelled by household consumption activity.

The unwinding of some pent-up consumer demand and a relaxation in the cautionary approach to spending adopted by Australians during the bleakest part of the pandemic has seen about half of the decline in final household consumption expenditure that occurred in the June quarter of 2020 return in the September quarter.

This strengthening in the economy, and especially within the labour market, has enabled the Treasurer in his MYEFO Statement to revise down Australia's budget deficit for 2020-21 by nearly $16 billion to (still an eye watering) $197.7 billion. About $11 billion of this decline reflects lower JobKeeper payments, while company tax and GST receipts are $7 billion higher.

Since the Budget the Government has also introduced several spending measures to provide further targeted health and economic support to the community, with the largest item being the extension of the coronavirus supplement to income support benefits including JobSeeker (worth about $3.2 billion).

The economic forecasts contained within MYEFO suggest that while public final demand is strong and household consumption looks to be returning, buoyed by high levels of consumer confidence – also driven largely by expectations that the successful vaccine discoveries will mean an end to this pandemic in the near future – investment activity and net exports will remain weak during the next two years.

Australia's current political and trade tensions with China are recognised in MYEFO as a downside risk to our economic recovery, but it also recognises these challenges impact a relatively small proportion of total exports. At an aggregate level, trade with China remains very strong, with Australian exports to China increasing by $16.6 billion during 2019-2020, albeit the value of iron ore exports alone rose by $21.2 billion during this period.

The current strength in iron ore prices has seen the government change its assumption in MYEFO and forecast the end of the September quarter 2021 as the date when the price of iron ore will return to US$55 per tonne. This still appears to be a very conservative assumption, given it was around 2015 when the annual average price for iron ore was last around US$55 per tonne.

Key insights

- The Australian economy has strengthened at a faster rate than was anticipated in the 2020-21 Budget released in early October.
- The consequence of this stonger recovery has been reduced JobKeeper subsidy payments, higher income taxes from individuals and companies and higher GST receipts. The net effect of these, and other impacts, is a lower than originally forecast budget deficit of $197.7 billion for 2020-21 and total savings across the forward estimates period of nearly $24 billion.

The flattened curve

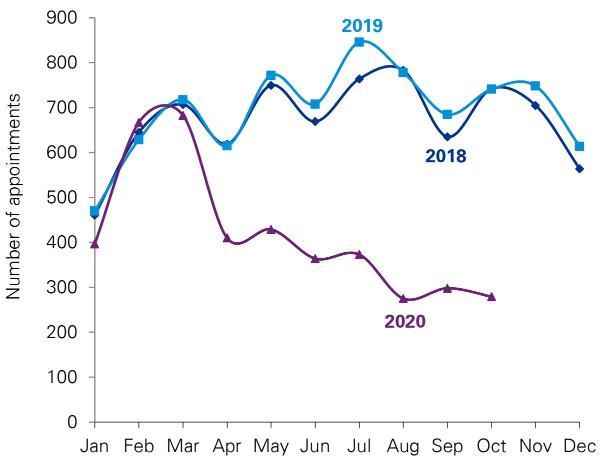
When COVID-19 first hit Australian shores in March, federal and state governments responded with a suite of stimulus measures aimed at avoiding widespread business failure and providing companies with a lifeline until normal trading resumed.

Nine months on, many of these measures are still in effect, some of which have been refined and have an exit plan (JobKeeper payments have reduced and are expected to cease altogether on 28 March 2021) whilst others, in the absence of any legislative changes, will cease on 31 December 2020 (insolvent trading relief for directors and the increase in statutory demand requirements).

The impact of these stimulus measures to date has been to reduce the number of business failures over the last nine months to levels below what we would expect to see in a normal trading environment.

In the 10-month period to 31 October 2020, there have been approximately 2,800 fewer insolvencies than in a normal trading year (let alone during a recession). This suggests that there are large number of "zombie companies" who continue to trade but without the benefit of the various stimulus, would usually have entered some form of insolvency process.

Companies entering into insolvency



James Stewart

National Leader,
Capital Solutions

Overview of small business insolvency law reform

On 10 December 2020, as part of its Economic Recovery Plan in response to the impact of COVID-19, the federal government passed legislation to enact changes to our insolvency system.

These changes are focused on small businesses (those with liabilities of less than $1million) and are aimed at simplifying the debt restructuring and liquidation processes for these companies. The changes draw on key features of the US Chapter 11 bankruptcy model and are being hailed as "the most important changes to Australia's insolvency framework in 30 years".

The reforms cover a number of different areas, but key points include:

Debt Restructuring

If a small business believes that it is, or may become, insolvent then the board can resolve to appoint a Small Business Restructuring Practitioner ("SBRP") to assist it in developing and implementing a debt restructuring plan for consideration and approval by creditors.

Once an SBRP has been appointed, the company enjoys the protection preventing creditors from commencing recovery actions against it while the plan is being developed. The main divergence from usual Australian insolvency laws is that the business remains under the control of its directors – this is commonly referred to as "debtor in possession".

Liquidation

For those small businesses which are no longer viable, the liquidation process has also been simplified with a view to reducing the time and costs associated with the liquidation process.

Liquidators of a small business no longer need to convene meetings of creditors, will have reduced obligations for reporting to the regulator and can report to creditors electronically.

Key insights

- As stimulus measures continue to retract and businesses are faced with the new, unassisted, post-COVID trading reality, it's inevitable we will see an increased number of companies facing financial difficulties.
- The reforms implemented by the Federal Government acknowledge this and are designed to assist small businesses, which account for over 75% of all insolvencies, either restructure their obligations, or exit the market.
- Businesses should now be focused on what their operations will look like as we move through 2021 and taking steps to right size themselves as the support from government is withdrawn.

Individuals

Extension of JobSeeker supplement

The JobSeeker Coronavirus Supplement will continue after its previously scheduled 31December cessation, but at a reduced rate. From 1 January until 31 March 2021, the supplement will apply at a reduced rate of $150 per fortnight (further scaled down from the original rate of $550 and the rate of $250 which applied from 25 September).

The expanded eligibility criteria and certain changes to income testing will continue to apply.

These measures recognise that people with limited financial resources who remain unemployed, or under-employed, will continue to require a higher level of government support.

Ben Travers

Partner,
Deals, Tax & Legal

Hayley Lock

Partner,
Deals, Tax & Legal

Personal income tax

Personal income tax cash receipts are expected to be slightly higher in 2020-21 than was estimated in the 2020-21 Budget ($218 billion in MYEFO as compared to $217.4 billion in the Budget).

It is anticipated that the personal income tax cuts delivered in the 2020-21 Budget will contribute to the recovery in household consumption through 2021.

Employers were instructed by the ATO to implement the new PAYG withholding rates to reflect the personal income tax cuts no later than 16 November 2020.

The personal income tax rate changes were backdated to 1 July 2020. However, the full impact of the reduction in tax rates could not be managed through PAYG withholding alone. Therefore, many individuals will receive a refund on lodgement of their 30 June 2021 individual income tax returns.

Key insights

- The personal income tax rates delivered in the 2020-21 Budget are expected to contribute to the recovery in household consumption through 2021.
- Many individuals in Australia can expect to receive a refund on lodgement of their individual tax return given that the backdated changes to the personal income tax rates could only be partially delivered through the PAYG withholding system.

Corporate income tax

Alternative test introduced for temporary full expensing.

As part of the Federal Budget, the Government announced a temporary full expensing measure which would allow a deduction for the full cost of eligible assets acquired and used by eligible businesses.

It has since been recognised that there are some limitations to the original measures and a need to expand the eligibility requirements. For example, many businesses would be ineligible because the aggregated turnover rules would require inclusion of the turnover of overseas affiliates and cause them to breach the $5 billion threshold.

This has resulted in the introduction of an alternative eligibility test, where a company with annual aggregated turnover of $5 billion or more will be able to access the measure if:

- it has less than $5 billion in total statutory and ordinary income (excluding non-assessable non-exempt income) in either the 2018-19 or 2019-20 income year, and
- it has invested more than $100 million in certain tangible depreciating assets in the period covering the 2016-17 to 2018-19 income years.

These businesses will be able to deduct the full cost of eligible tangible depreciable assets acquired from 7:30pm AEDT on 6 October 2020 and first used or installed ready for use by 30 June 2022. Businesses that qualify under the existing $5 billion aggregated annual turnover test will not be required to apply the alternative test.

Businesses will also be allowed to opt-out of temporary full expensing and the Backing Business Investment incentive on an asset-by-asset basis. This will provide greater flexibility in accessing the incentives to encourage businesses to bring forward investment.

Gabby Burcul

Partner,
Deals, Tax & Legal

Denis Larkin

Director,
Deals, Tax & Legal

Loss carry back tax offset

The loss carry back tax offset has been legislated, consistent with the Federal Budget announcement.

Eligible corporate tax entities with an aggregated turnover of less than $5 billion will be allowed to carry back tax losses generated in the 2019-20, 2020-21 or 2021-22 income years to offset previously taxed profits in the 2018-19 or later income years. The loss carry back regime operates as a refundable tax offset, effectively providing a cash refund for tax previously paid.

Notably, an offset relating to a tax loss for the 2019-20 income year can only be claimed on lodgement of the 2020-21 tax return, effectively delaying access to the benefit by a year.

The Australian Taxation Office has also released further information regarding the application of the new rules. This confirms that eligible corporate entities can claim the refundable tax offset after the end of their 2020-21 and 2021-22 income years, when lodging their 2021-21 and 2021-22 company tax returns.

Key insights

- An alternative eligibility test has been introduced to enable greater flexibility to access the temporary full expensing measure and encourage business investment.
- The temporary loss carry back tax offset measure announced in the Federal Budget has been legislated to encourage business investment during the recovery.

Enterprise

Expanded Eligibility for the Instant Asset Write Off

The Federal Budget included a significant expansion to the instant asset write-off that enabled businesses with aggregated global turnover below $5 billion to access an immediate deduction for certain depreciable assets.

However, the aggregated turnover test resulted in many medium sized Australian businesses with large overseas operations to miss out on the deduction.

To address this, the government will now introduce an alternative eligibility test whereby taxpayers with Australian assessable income of less than $5 billion in recent income years, and who meet certain depreciable asset investment thresholds, will now also be eligible.

Qualifying businesses will be able to deduct the full cost of eligible assets acquired from 7:30pm AEDT on 6 October 2020 and first used or installed ready for use by 30 June 2022.

HomeBuilder Scheme Extension

As announced in late November, the government has extended the eligibility period for the HomeBuilder scheme to 31 March 2021 (originally due to end on 31 December).

The grants for contracts entered into during this extended period (i.e. 1 January to 31 March 2021) will be reduced to $15,000 (formerly $25,000). Construction must commence within 6 months of the contract being signed.

The new build price cap for Victoria and New South Wales has also been raised for contracts entered into during this extended period to $850,000 and $950,000 respectively. It remains at $750,00 for all other states.

Brett Mitchell

National Leader,
Tax, Transactions & Accounting,
Enterprise

Clive Bird

Partner,
Enterprise

Employment related measures since the Federal Budget

The government is providing $70.9 million of funding to support the proposed industrial relations reforms, including $47.3 million over four years to the Fair Work Ombudsman to prevent and rectify wage underpayments. Therefore employers should review their payroll systems and controls, and consider whether there is a need to invest in improving compliance.

Part of the JobMaker Plan introduced in the budget included an incentive for employers to take on new apprentices and trainees through the Boosting Apprenticeship Commencements scheme. The subsidy is worth up to $7,000 per quarter, and available for commencements from 6 October 2020to 30 September 2021.

Subsequent changes now apply a 30-worker limit for employers seeking to convert existing casual or part-time workers, however there is no limit for trades-based Australian apprenticeships. Employers should register as soon as possible as the subsidy is capped at 100,000 apprentices.

This incentive is positive news for employers as they gear up for the burgeoning infrastructure investment which will require more skilled labour.

Key insights

- Small and medium enterprise will benefit from the the government’s record spending and ongoing commitment to investment in infrastructure.
- Extending access to the instant asset write-off measures to Australian subsidiaries of large global groups is a welcome measure and consistent with the government’s intention to encourage foreign investment in Australia.
- The extension to the HomeBuilder scheme is expected to lead to a further 15,000 construction projects, which will bolster the nation’s important housing and construction industry.
- Employers should embrace the government’s ongoing employment support measures, such as JobMaker, and ensure they have robust systems in place to avoid underpayment of wages, given the the government’s increased focus on this space.

Contact us

KPMG Leadership

Chief Executive Officer
Gary Wingrove
+61 2 9335 8225
gwingrove@kpmg.com.au

National Chair
Alison Kitchen
+61 3 9288 5345
akitchen@kpmg.com.au

Deals, Tax & Legal
David Heathcote
+61 2 9335 7193
dheathcote@kpmg.com.au

Audit, Assurance & Risk Consulting
Andrew Yates
+61 2 9335 7545
ajyates@kpmg.com.au

Enterprise
Paul Howes
+61 2 9346 6073
paulhowes@kpmg.com.au

Management Consulting
Ian Hancock
+61 2 9335 8161
ianhancock@kpmg.com.au

Deals, Tax and Legal Leadership

Capital Solutions
James Stewart
+61 3 8667 5728
jhstewart@kpmg.com.au

Specialist Tax & Reward
Ben Travers
+61 3 9288 5279
btravers1@kpmg.com.au

Technology, Innovation, Solutions & Ventures
Matt Herring
+61 3 9288 6845
mherring@kpmg.com.au

Strategy & Transactions
Karina Collins
+61 7 3225 6827
kacollins@kpmg.com.au

Direct Tax
Justin Davis
+61 2 9335 8854
jcdavis@kpmg.com.au

Legal, Infra & Real Estate
Kate Marshall
+61 3 9288 5767
katemarshall@kpmg.com.au

Clients & Markets
Angus Wilson
+61 2 9335 8288
arwilson@kpmg.com.au

Economics & Tax Centre
Grant Wardell-Johnson
+61 2 9335 7128
gwardelljohn@kpmg.com.au

Economics & Tax Centre
Brendan Rynne
+61 3 9288 5780
bjrynne@kpmg.com.au

Enterprise
Brett Mitchell
+61 2 9335 7398
bmitchell@kpmg.com.au

Enterprise
Clive Bird
+61 3 9288 6480
clivebird@kpmg.com.au

Industry Leadership

Corporates
Trent Duvall
+61 2 9335 8871
tduvall@kpmg.com.au

Energy & Natural Resources
Cassandra Hogan
+61 2 9455 9642
cjhogan@kpmg.com.au

Financial Services
Daniel Knoll
+61 2 9455 9148
danielknoll@kpmg.com.au

Infrastructure, Government & Health
Paul Low
+61 7 3233 9771
plow@kpmg.com.au

KPMG.com.au