Parliament of Australia
Parliamentary Budget Office

Phil Bowen PSM FCPA
Parliamentary Budget Officer

Senator Christine Milne
Leader of the Australian Greens
Parliament House
CANBERRA ACT 2600

Dear Senator Milne

Please find attached a response to your costing request, *Caring for small business* (letter of 14 August 2013).

The responses to these requests will be released on the PBO website (www.aph.gov.au/pbo).

If you have any queries about this costing, please do not hesitate to contact Colin Brown on (02) 6277 9530.

Yours sincerely

Phil Bowen
20 August 2013

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COSTING – ELECTION CARETAKER PERIOD

Name of proposal:	**Caring for small business**
Summary of proposal:	The proposal would: Part 1: reduce the company tax rate to 28 per cent for small companies with turnover less than $2 million, Part 2: increase the instant asset write-off threshold for small business from $6,500 to $10,000, and Part 3: establish a stronger and better resourced Small Business Commissioner. The intention of the proposal is to provide better support for Australia's small business owners. The proposal would have effect from 1 July 2014.
Person/party requesting costing:	Senator Christine Milne, Australian Greens Party
Date costing request received:	14 August 2013
Date costing completed:	19 August 2013
Date of public release of policy:	8 August 2013
Additional information requested (including date):	On 19 August 2013 the PBO sought clarification of what franking rate would apply to small businesses under this proposal.
Additional information received (including date):	On 19 August 2013 the Director of Policy indicated that the company tax cut for small business is not intended to alter the rate that small businesses frank their dividends.
Agencies from which information was obtained:	Not applicable

Costing overview

This proposal is estimated to decrease both the underlying cash and fiscal balances by $2.49 billion over the 2013-14 Budget forward estimates period. This impact is largely due to decreased revenue. The impact includes some relatively small departmental and administrative expenses. Detailed financial implications for this proposal are at Table 1 of Attachment A.

This proposal would have an ongoing impact that extends beyond the forward estimates period. Part 1 of the proposal is estimated to cost around $750 million per annum just beyond the forward estimates period and grow in line with general company tax growth rates from this time. Part 2 of the proposal would have an ongoing cost of approximately $50 million per annum beyond the forward estimates period. Part 3 would also have an ongoing cost of $10 million per annum beyond the forward estimates period.

The PBO has estimated departmental expenses associated with part 1 of this proposal to be around $2.5 million per annum, with total expenditure being $10 million over 4 years. This estimate is based on the costings of similar proposals that have recently been estimated by the Australian Taxation Office (ATO), such as the *early start to the company tax rate cut for small business companies* measure on page 39 of the *2010-11 Budget Paper No. 2*. Part 3 of this costing includes around $4.3 million in departmental funding over the 2013-14 forward estimates period. Departmental cost estimates are included at Table 2 of Attachment A.

Part 1 of this costing is considered to be of medium reliability as modelling is based on historical tax data and several assumptions. Possible behavioural responses to the proposal are uncertain. Part 2 of this costing is considered to be of low reliability as it is heavily reliant on assumptions regarding growth in investment by small businesses and the proportion of assets valued between the current threshold and the proposed threshold. Part 3 of this costing is considered to be of high reliability as funding for this part is a capped amount.

The estimated impact for part 1 of this costing differs from those presented in the applicant's costing request because of the use of a more detailed approach to costing the impact of the company rate cut since the previous estimates were provided. For all parts of this costing, base data has been updated to reflect the *2013 Pre-Election Economic and Fiscal Outlook* report parameters.

Table 1: Financial implications of parts 1 to 3 of this proposal (outturn prices)[(a)]

Impact on	2013-14	2014-15	2015-16	2016-17
Underlying cash balance ($m)	-52.5	-162.5	-1062.5	-1212.5
Fiscal balance ($m)	-52.5	-162.5	-1062.5	-1212.5

(a) A negative number for the fiscal balance indicates a decrease in revenue and an increase in expenses in accrual terms. A negative number for the underlying cash balance indicates a decrease in receipts and an increase in payments in cash terms.

Key assumptions

Assumptions detailed in the costing request:

- All parts of this proposal would apply from 1 July 2014.

The PBO has made the following assumptions regarding part 1 of this costing:

General assumptions

- Superannuation funds and the superannuation business of life insurance companies continue to be taxed at the 15 per cent rate.
- Growth rates are based on company gross operating surplus (GOS), adjusted to take into account the effects of many companies having substituted accounting periods.
- Estimates have been rounded to the nearest $50 million.

Behavioural 'bring forward' assumption

- Given the start date of 1 July 2014 and announcement of this proposal during the 2013 election campaign, the PBO considers that there is sufficient time for companies to take steps to change the timing of their deductions and income in the financial year prior to the start date in order to benefit from the changes in the company rate. Having a long lead time increases the likelihood of a behavioural response that would increase the cost of transition to the proposal and decrease revenue.

Impact of the imputation system

- As the cut in the company tax rate under this proposal reduces the company tax rate applicable to small companies, there would be an ongoing impact on the rate at which dividends paid to shareholders of these companies are franked. As requested by the applicant, the following assumption has been adopted in this costing.
  - The rate at which dividends paid to shareholders of small companies are franked remains at 30 per cent in order to simplify the system. Under this assumption, franking credits continue to attach at a rate of 3/7ths of the fully franked cash dividend paid regardless of the change in the company tax rate for small companies.

Timing assumptions

- This costing assumes that the ATO will not vary company instalment calculations in response to the change in company tax rates. Company tax instalment rates are calculated by the ATO based on the amount of tax paid by a company in the previous year and are not based on the statutory company rate. The assumption in relation to instalments mainly impacts on the profile of company tax collections as instalments adjust to the new company rate and does not affect the cost of the proposal once instalments assimilate the new company rate. If the ATO were to vary instalments to take account of the impact of the new company rate, the cost of the proposal would be larger in the first year following the date of effect than in this costing, with this difference expected to be unwound over the next three years.

The PBO has made the following assumptions regarding part 2 of this costing:

- Assets valued between $6,500 and $10,000 are currently depreciated using the diminishing value method and are assumed to have an effective life of five years.
- All eligible businesses will opt-in to using the instant asset write-off.
- Companies do not vary their instalment amounts from those specified by the ATO in response to this part of the proposal.

Methodology

Part 1 of this proposal was estimated by calculating company and shareholder tax revenue using the proposed tax structure and various assumptions over the 2013-14 Budget forward estimates period and subtracting the amount of base company and shareholder tax revenue that is expected to be collected over the same period.

For part 2 of this proposal, the PBO estimated the value of small business investment in assets valued between $6,500 and $10,000 over the forward estimates period using data from the ATO and the Australian Bureau of Statistics (ABS). The cost of the proposal was estimated by calculating the aggregate value of depreciation for assets valued between $6,500 and $10,000 under the immediate write-off and subtracting the depreciation value under the base case (using the diminishing value method of depreciation). The resulting cost estimates were then adjusted to reflect the estimated timing of company tax collections.

For part 3, the cost is capped at $10 million per annum from 2014-15 to establish a stronger and better Small Business Commissioner.

Data sources

- Data sources include ATO tax return data for companies, individuals and the superannuation business of life insurance companies up to the 2009-10 financial year. The data includes entities that are taxed as companies.
- ATO, *Taxation Statistics 2009-10*
- ABS, *5204.0 Australian System of National Accounts*

ATTACHMENT A: DETAILED FINANCIAL IMPLICATIONS

This attachment includes detailed financial impacts for each part of the costing.

Costing Part	Revenue	2013-14	2014-15	2015-16	2016-17	Total
1 Reduce the company rate from 30.0 per cent to 28.0 per cent (for companies with turnover less than $2 million)	*Companies*	-50	-100	-750	-950	-1,850
	Individuals	-	-	-	-	-
	Total	**-50**	**-100**	**-750**	**-950**	**-1,850**
2 Increase the instant asset write-off threshold from $6,500 to $10,000.	*Companies*	-	-50	-300	-250	-600
	Total	**-**	**-50**	**-300**	**-250**	**-600**

Note: A negative number for the fiscal balance indicates a decrease in revenue in accrual terms. A negative number for the underlying cash balance indicates a decrease in revenue receipts in cash terms.

Table 2: Expense impacts - fiscal balance and underlying cash basis ($m)

Costing Part	Expense	2013-14	2014-15	2015-16	2016-17	Total
1 Reduce the company rate from 30.0 per cent to 28.0 per cent (for companies with turnover less than $2 million) - Departmental expense	*Departmental*	-2.5	-2.5	-2.5	-2.5	-10.0
	Total	**-2.5**	**-2.5**	**-2.5**	**-2.5**	**-10.0**
3 Small Business Commissioner	*Expense*	-	-10.0	-10.0	-10.0	-30.0
	Total	**-**	**-10.0**	**-10.0**	**-10.0**	**-30.0**

Note: A negative number for the fiscal balance indicates an increase in expenses in accrual terms. A negative number for the underlying cash balance indicates an increase in expenditure in cash terms. Totals may not add due to rounding.