BRIEFINGS

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Pride & Prejudice: Top Four Predictions for 2017

The global economy is picking up and Australia is about to secure the global record for the longest period a country has gone without a recession. But with the focus on the political environment, there is an uneasiness in the market and with uneasiness comes a reticence to take risks. The fortunes of Australians this year will have much to do with how you or your business is positioned and how you respond to challenges. Here are our top predictions:

1. Trumponomics will impact on our region

Business is business - either an opportunity makes sense or it doesn't. The biggest pressure from the new US President is unlikely to be the much discussed Trans-Pacific Partnership (Australia's current Free Trade Agreement with the US (AUSFTA) has been in place since 2005), or President Trump's controversial immigration policies, but the plan to cut the US Federal company tax rate from 35% to boost competitiveness. If the US drops its company tax rate below 30%, Australia will be the one of the most expensive countries in its region to do business and globally uncompetitive. The 2016-17 Federal Budget announcement to reduce Australia's company tax rate progressively to 25% for all businesses has stalled in the Parliament with voter perception that it is a gift to 'big business' at the expense of more deserving elements of the community.

The US is Australia's second largest two-way trading partner at around $69 billion and our third largest export market at $22 billion* (we import around $47 billion in US goods and services). Australia's trade relationship with China however swamps this volume with $150 billion in two-way trade of which almost $86 billion is in exports. These trade statistics are important to remember when we look at the geopolitical landscape of the Asia-Pacific region and in particular the increasingly antagonistic relationship between the United States and China.

Australia is too small an economy to successfully survive on its domestic market alone. Strong regional alliances and competitiveness are critical.

2. For Business: Innovate or Perish

Economists widely predict that residential construction and exports - the mainstay of Australia's domestic economic growth - will slow in 2017. Part of this is the Chinese Government's concern about investment outflows (Australia has been a significant beneficiary with Chinese Direct Foreign Investment growing by 72.5% over 2010-15). So, where is growth going to come from?

One of the most alarming statistics comes from the Boston Consulting Group Global Manufacturing Cost-Competitiveness Index.

The BCG analysis demonstrates that Australia was the least competitive of the top 25 global manufacturers between 2004-14 – Australia's direct manufacturing costs, for example, were just under 30% higher than the US. Manufacturing wages grew 48% in Australia over this period while labour productivity fell 1%. While this was a period of abnormal events with the mining boom, the Australian dollar at parity with the US, and a GFC, it still creates a stark picture of why a focus on productivity is important.

Over the last two decades we have seen a global trend towards offshoring to reduce labour costs to achieve productivity gains. Now, gains are being achieved through innovation to reduce costs. This is an area where Government policy is there to support business. These incentives include:

- Small business rollover relief that removes the tax impediments associated with changing your business structure.
- Tax incentives for investors in early stage innovation companies.

- Broadened tax incentives for early stage venture capital limited partnerships and venture capital limited partnerships.
- More generous employee share scheme arrangements particularly for high growth start-ups.
- Immediate deductions for start-up businesses.
- Reduced company tax rates for small businesses.
- Plus there is also the R&D incentives for innovative companies.

For survival, all business operators need to look at the trends in their industry. Advances in technology in particular will make some operators unsustainable and give others the capacity to change the very nature of their sector either through production efficiencies or disruption. After all, tech company Uber started in 2009, spreading exponentially around the world well before it launched in Australia in 2014. Real Estate Agents may be next with companies like Purplebricks.

The bottom line is that you cannot rely on the stability of your business model to sustain over time.

3. For you: Superannuation knee-jerk reactions will disadvantage some

2017 will be a watershed year for superannuation in Australia. With many of the reforms coming into effect on 1 July 2017, there will be a temptation for many to 'do something' before the deadline.

The biggest impact of the reforms is likely to be on those with large super balances close to or exceeding $1.6 million. And, it's not just the wealthy with large super balances. Many SME business operators utilise the business real property exception to hold their business premises inside their SMSF, which can significantly increase the asset value of the fund. For anyone close to or exceeding the $1.6m cap, it's essential that you have current valuations for your assets to know exactly where you stand.

One of the key decision points for those with large balances is how Capital Gains Tax applies where assets supporting pension payments exceed the new $1.6m pension transfer limits and need to be moved back into accumulation phase.

Knee-jerk reactions to the management of your fund's assets - like quickly selling assets pre 1 July - may result in your fund being in a much worse position. With the risk of sounding conflicted, good advice is essential.

4. International is still a dirty word

If you are an individual or a business that transfers money internationally, you will continue to be a target. For individuals, if you work overseas be careful of residency issues. The residency tests don't necessarily work on 'common sense'. Just because you work outside of Australia for a period of time does not mean you are not a resident for tax purposes.

And, for those with international investments, it's important to understand the tax status of earnings from those assets. Just because the asset and the earnings from those assets are overseas does not mean they are safe from Australian tax law, even if the cash stays outside Australia.

For business, Government regulation is increasingly cynical about those using low taxing jurisdictions, paying large management fees between international entities, and parking large debts in Australian entities.

Like every other tax authority, the Australian Tax Office wants its share of profits earned from Australian consumers. You can see this trend in the new GST rules (dubbed the 'Netflix tax') which come into effect on 1 July 2017 - although for many the requirement for foreign entities to charge GST on services and digital products provided to Australian consumers has already come into effect. On the other hand, changes to the GST treatment of international transactions that apply from 1 October 2016 are intended to make life easier for both Australian and overseas businesses, but these rules can become quite complex to apply in real life.

No one likes uncertainty and 2017 is shaping up to be a year where people feel unsettled. Take a breath, think strategically, look beyond your personal experience, and take advantage of the opportunities that are available to you.

**2015-16 figures Austrade Why Australia Benchmark Report 2017.*