

## HENRY TAX REPORT

### **Executive Summary**

Henry Tax Report and Government's response released

### **Resources Sector**

Resources "super profits" tax

Resource exploration rebate

### **Business Taxation**

Reduction in company tax rate

Small business asset write-off

### **Superannuation**

Superannuation Guarantee: rate phased increase to 12%

Superannuation Guarantee: age limit raised to 75

Concessional contributions caps for over 50s to continue

Government superannuation contributions for low-income earners

### **Infrastructure**

State infrastructure funding

### **Recommendations Rejected by Government**

Summary of recommendations rejected by the Government

### **Other Henry Recommendations**

Henry recommendations neither accepted nor rejected

## EXECUTIVE SUMMARY

### Henry Tax Report and Government's response released

On Sunday, 2 May 2010, 4 months and 9 days after the Government received the final report of the Australia's Future Tax System review team (the Henry Report, as it has become known), the Government publicly released the report and its initial response. However, although the Henry Report contains sweeping recommendations to reform Australia's tax system, the Government has initially focused on the resources sector and superannuation. The company tax rate is also to be reduced and there are some benefits for small business.

### Main reforms

The highlights are:

- a Resource Super Profits Tax that will tax non-renewable resource projects (at a rate of 40%) on their profits rather than just their production (taxpayers will be eligible for a credit for royalties paid to State and Territory Governments) - this will apply from 1 July 2012;
- a refundable tax offset (the Resource Exploration Rebate) at the company level, set at the prevailing company tax rate, for exploration expenditure in Australia incurred on or after 1 July 2011;
- reduction in company tax rate to 28% - small businesses will benefit from 2012-13, but it will be phased in for other companies (29% for 2013-14 and 28% from 2014-15);
- small businesses will be able to immediately write-off assets valued at under \$5,000 (currently \$1,000) and all other assets (except buildings) will be written off in a single depreciation pool at a rate of 30% - this will apply from 1 July 2012;
- Super contributions cap concession: workers aged 50 and over with super balances below \$500,000 will be able to make up to \$50,000 in annual, concessional superannuation contributions - to apply from 1 July 2012;
- Superannuation Guarantee age limit will be increased from 70 to 75 from 1 July 2013;
- Superannuation Guarantee rate will rise to 12% by 2019-20 (to be phased in); and
- Government will provide a \$500 annual superannuation contribution to individuals with an adjusted taxable income up to \$37,000.

The Henry Report is in 3 volumes (totalling about 1300 pages) - an Overview (Vol 1) and 2 Detailed Analysis reports - and contains 138 recommendations. The Government's initial response - called Stronger-Fairer-Simpler, A tax plan for reform - deals with less than 50 of the recommendations and is contained in 3 short booklets, a number of fact sheets and 3 media releases.

The Prime Minister and the Treasurer said that "the first wave of [its] agenda is to reform resource, company and small business taxes and superannuation". They also said that they are "attracted to developing changes in a number of other areas considered by the [Henry Report], especially making

tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system.” However, these will be considered in the government’s second term (if re-elected).

Some Henry Report recommendations have been specifically rejected, including: removing the CGT exemption for pre-CGT assets; applying a discount to negative gearing deductions; reducing indexation of the age pension; including the family home in means tests; removing the Medicare levy; introducing a bequests tax; indexing fuel to CPI; removing the luxury car tax; and changing alcohol tax (in the middle of a wine glut and where there is an industry restructure underway). See further para [690] of this Bulletin.

The Prime Minister and the Treasurer said that other recommendations in the Henry Report are not government policy and should be debated further in the coming years. The recommendations that have neither been adopted nor rejected are listed at para [691] of this Bulletin.

### ***Where to get documents***

The Government’s response entitled, Fairer, Stronger, Simpler: Tax Plan for Our Future, is available via the Treasury’s Future Tax Website. See also the Australia’s Future Tax System Review Website.

## RESOURCE SECTOR

### *Resources “super profits” tax*

A Resource Super Profits Tax (RSPT) will be introduced on 1 July 2012 at a rate of 40% on profits made from the exploitation of Australia’s non-renewable resources. Details of the RSPT are contained in a separate Paper, The Resource Super Profits Tax: a fair return to the nation.

The RSPT will apply to all legal entities (companies, partnerships and trusts) directly involved in the exploitation of Australia’s non-renewable resources. In principle, RSPT will only be payable on resource extraction activities. The RSPT will not be levied on shareholders in a company or beneficiaries of a trust that are involved in exploitation of non-renewable resources.

The RSPT will be calculated separately for each project interest. This is important for joint ventures where partners contribute different capital to a project.

RSPT payments will be deductible for income tax purposes. Conversely, RSPT refunds will be assessable for income tax purposes. Resource entities will continue to be subject to income tax on their exploration and production activities. Projects within the scope of the Petroleum Resource Rent Tax (PRRT) will have the option of opting into the RSPT or staying in the PRRT (see transitional arrangements below). The election into the RSPT will be irrevocable.

The RSPT will replace the crude oil excise and operate in parallel with State and Territory royalty regimes.

The Government’s proposals largely adopt Recommendations 45-47 of the Henry Report (although the Report recommended that the RSPT replace the State and Territory royalty regimes).

### *How the RSPT works*

The RSPT will be charged at a rate of 40% of assessable resource profits, ie assessable revenue less deductible expenses including an allowance for capital expenditure (see below).

The RSPT will assess receipts from the sale of the resources. The RSPT will exclude receipts from the transfer of ownership in the resource project among shareholders. Assets leaving a project will be subject to a balancing adjustment.

The RSPT will allow deductions for the cost of extracting resources and getting them to the taxing point. Exploration expenditure will be immediately deductible under the RSPT. The following types of expenditure will not be deductible under the RSPT:

- payments of interest and financing costs, including the cost of issuing shares, the repayment of equity, the
- payment of dividends, and financial hedging costs;
- payments to acquire an interest in an existing exploration permit, retention lease, development licence, production

- licence, pipeline licence or access authority;
- payments to acquire interests in projects subject to the RSPT; and
- payments of income tax or GST.

RSPT losses will be carried forward with interest to preserve their real value. An RSPT loss occurs when project costs, including the RSPT allowance, are greater than the project's receipts in a given year. While losses may not be immediately refunded, the government will guarantee to provide a tax credit for unutilised losses even if the entity goes out of business.

Qualifying expenditure incurred within a year can be transferred from the loss making project to other profitable projects within the entity or company group. Where there are no other profitable projects, the loss will be carried forward. Carry forward losses, included in the RSPT capital account, can be used to offset future assessable resource super profits within the entity or wholly owned company group. The amount that can be transferred out in a year is limited by the amount of assessable RSPT profit in other projects owned by the entity or within the company group.

That is, transferred losses cannot drive the RSPT assessable profit below zero.

The RSPT value of losses will be refunded on a reasonable basis. For example, losses would be refunded when a project is closed and the loss cannot be transferred to another project.

Under the RSPT, the government effectively guarantees to give resource firms the benefit of 40% of their extraction costs on the equivalent of a cash-flow basis (the RSPT allowance preserves the real value of the benefit). That is, the government guarantees to provide relief for expenditures incurred on a project, including the possibility of a cash refund. In return, it will receive 40% of the resource super profits.

### ***RSPT capital account***

The RSPT capital account is a tax account that records undepreciated tangible capital expenditure and unutilized losses. Essentially, it keeps record of the tax credit carried forward. The closing balance of the RSPT capital account from the previous tax year is used to calculate the RSPT allowance, which is deducted from revenue to determine the RSPT liability. The RSPT allowance compensates investors for the deferred tax credit.

The RSPT allowance rate will be set annually at the 10-year government bond rate.

### ***Taxing point***

The taxing point is the point at which revenues and costs are determined for assessing RSPT.

The Henry Report suggests that, in principle, the taxing point be set close to the point of extraction of the resource - for example, the mine gate or well-head - to be consistent with taxing the market value

of the underlying non-renewable resource. It notes, however, that the value of a resource at this stage in the production process is sometimes not observable and may need to be derived.

A practical approach would be to set the taxing point where a saleable commodity exists (the earliest point that a world-price or arm's-length sale occurs), similar to the case under the existing PRRT. For some commodities, this may include processing and transportation.

Extending the taxing point may reduce compliance costs and recognise the co-dependency of the value of extracted resources with resource transport or processing in integrated operations. Extending the taxing point could also prevent insufficient recognition of capital costs.

### ***Transitional arrangements***

The RSPT will apply to all existing resource projects, except those already within the scope of the PRRT regime. As noted above, these projects will have the option of electing into the RSPT regime or staying in the PRRT regime. To provide certainty for projects already covered by the PRRT, the Commonwealth will consult with industry on arrangements that would allow an irrevocable election into the RSPT. The Government anticipates that, over time, many projects within the scope of the PRRT will migrate into the RSPT.

Existing projects will be transitioned into the RSPT with a generous RSPT starting base to reduce future RSPT liability in recognition of past investment. This RSPT starting base can be deducted against RSPT revenue from the project but is not transferable between projects or refundable. Capital expenditure between the announcement and commencement of the RSPT (the interim period) will be entitled to the RSPT loss transfer rules and loss refund rules following commencement.

For projects subject to the RSPT, the Government will recognise in the RSPT starting base, the accounting book value of existing project assets as at the most recent audited accounts available at the time of announcement. The book value will be required to reflect a value consistent with Australian Accounting Standards. Market valuation will be used where audited accounting book values are not available.

If the asset is acquired after the accounts are audited but before announcement of the RSPT, the assets historical cost will be included in the starting base. Taxpayers will be able to increase their RSPT capital account to account for the acquisition of new capital.

To do this, all acquisitions of capital and exploration expenditure during the interim period will be included in the RSPT capital account valued at its historical cost and indexed, from the time of purchase, at the RSPT allowance rate. Acquisitions of capital and exploration expenditure will not be depreciated for RSPT purposes during the interim period. Where an asset is disposed of during the interim period, the asset's indexed RSPT capital account value will be removed from the RSPT capital account.

To soften the impact on after tax cash flows following commencement, the Government will allow early access to the RSPT starting base through accelerated depreciation of the base over the first 5 years of operation of the RSPT.

### ***Credit for State royalties***

A refundable credit for royalties paid to State and Territory Governments will be available. The refundable credit will eliminate investment distortions associated with the state royalty systems and ensure there is no “double taxation” of resource profits.

### ***Consultation***

The Government will consult extensively with stakeholders on the design of the RSPT, including the details of defining receipts and expenditure that fall within the RSPT, ways to apportion expenses between project and non-project activity, as well as operational hedging gains and costs, and the feasibility of a flexible approach to setting the taxing point. The consultation will also cover the need for exemptions from the RSPT where, due to compliance costs, there is no net benefit to society in applying the RSPT. In particular, the government recognises that better mechanisms will be needed to deal with small businesses and micro operators (such as one person prospectors). This includes the possibility of allowing capital expenditure, up to a cap, to be immediately deductible.

An alternative option for micro operators is to exclude them from the system, but require them to pay an access charge. Most States currently have similar arrangements under their existing royalty systems.

The first phase of consultation with industry will focus on the design of the transitional arrangements to ensure they are fair on firms while maintaining the integrity of the RSPT objectives.

Source: Stronger-Fairer-Simpler Fact Sheets [p 19-28]; The Resource Super Profits Tax: a fair return to the nation; Henry Report Overview [p 47-48]

### ***Resource exploration rebate***

The Government will introduce a refundable tax offset (the Resource Exploration Rebate) at the company level, set at the prevailing company tax rate, for exploration expenditure carried out in Australia. The offset will be available for exploration expenditure incurred on or after 1 July 2011.

The definition of exploration expenditure will be expanded to include expenditure incurred in exploring for geothermal energy. All companies will be able to access the offset, to avoid the complexity of defining the concept of an “Australian small listed exploration company” in the tax law.

The Government will consult on the exposure draft legislation to give effect to the offset. This proposal adopts Recommendation 32 from the Henry Report.

Source: Stronger-Fairer-Simpler Fact Sheets [p 7]

## BUSINESS TAXATION

### *Reduction in company tax rate*

The company tax rate will be reduced to 28%. The timing of this will depend on whether an entity qualifies as an “eligible small business company”.

The Treasurer states that the reduction will be funded through the introduction of the Resource Super Profits Tax: see para [681] of this Bulletin.

### *Companies*

The reduction in company tax rate is to be done in 2 stages, commencing from the 2013-14 income year.

| Income year               | Corporate tax rate (%) |
|---------------------------|------------------------|
| 2012-13 (ie current rate) | 30                     |
| 2013-14                   | 29                     |
| 2014-15                   | 28                     |

### *Eligible small business companies*

Eligible small business companies will move straight to the 28% rate with effect from the 2012-13 income year. The rate for small business companies will start one year before the phase-in for other companies.

There is no indication in the Government papers as to what entities will qualify as eligible small business entities. The papers do indicate that there are approximately 720,000 small business companies that can benefit from this measure.

The Henry Report recommended that the small business entity turnover threshold should be increased from \$2m to \$5m, with adjustments to the \$6m net asset value test recommended for consideration: Recommendation 30. There is no formal response to this Recommendation: see [691] of this Bulletin.

The Fact Sheet states that the Government will consult on exposure draft legislation, with “relevant issues” to include instalment and franking arrangements.

### *Henry Report Recommendation*

The Henry Report recommended that the company tax rate should be reduced to 25% over the “short to medium term”: Recommendation 27.

Source: Stronger-Fairer-Simpler Fact Sheets [p 1]; Henry Report Overview [p 42]

### *Small business asset write-off*

The existing capital allowance concessions available for small businesses will be expanded by:

- allowing small businesses to immediately write-off assets valued at under \$5,000 (\$1,000 under the present law); and
- allowing small businesses to write-off all other assets (except buildings) in a single depreciation pool at a rate of 30% (currently, small businesses allocate assets to 2 different depreciation pools).

This proposal adopts Recommendation 29 of the Henry Report.

This measure will commence from 1 July 2012. The Government will consult on the details of the changes in 2010-11.

Source: Stronger-Fairer-Simpler Fact Sheets [p 5]; Henry Report Overview [p 41]

## SUPERANNUATION

### ***Superannuation Guarantee: rate phased increase to 12%***

The superannuation guarantee rate will increase from 9% to 12%, phasing in from 1 July 2013. There will be increments of 0.25% in the first 2 years and 0.5% thereafter.

| Commencing Super              | Guarantee rate (%) |
|-------------------------------|--------------------|
| 1 July 2013 (ie current rate) | 9                  |
| 1 July 2014                   | 9.25               |
| 1 July 2015                   | 9.5                |
| 1 July 2016                   | 10                 |
| 1 July 2017                   | 10.5               |
| 1 July 2018                   | 11                 |
| 1 July 2019                   | 11.5               |
| 1 July 2020                   | 12                 |

### ***Henry Report Recommendations***

The Henry Report made no specific recommendation about the superannuation guarantee rate. The only recommendations relating specifically to the SG are that:

- superannuation guarantee contributions should be paid at the same time as wages; and
- employers should report superannuation contributions to their employees when a contribution is made: Recommendation 23

Source: Stronger-Fairer-Simpler Fact Sheets [p 7]; Henry Report Overview [p 41]

### ***Superannuation Guarantee: age limit raised to 75***

The Superannuation Guarantee age limit will be raised from 70 to 75, with effect from 1 July 2013.

Currently, the SG only applies to people aged to 70. However, employers can make deductible super contributions for employees aged under 75, while self-employed people can make deductible contributions until they turn 75.

The commencement date of 1 July 2013 is designed to coincide with the increase in the SG rate. The Government papers state that around 33,000 employees are expected to benefit from this measure.

### ***Henry Report Recommendation***

The Henry Report recommended that the restriction on people aged 75 and over from making contributions should be removed and that a work test should still apply for people aged 65 and over: Recommendation 20.

Source: Stronger-Fairer-Simpler Fact Sheets, p 13; Henry Report Overview, p 34

## ***Concessional contributions caps for over 50s to continue***

From 1 July 2012, the Government will allow individuals aged 50 and over with total superannuation balances below \$500,000 to make up to \$50,000 in concessional superannuation contributions.

The current \$50,000 superannuation concessional contributions cap for individuals aged 50 or over is a transitional cap scheduled to expire from 1 July 2012.

Under the Government's measure, the \$50,000 cap will be extended permanently for individuals aged 50 or over with total superannuation balances of less than \$500,000.

This means that individuals aged 50 or over with total superannuation balances of less than \$500,000 can continue to make up to \$50,000 per year in superannuation concessional contributions.

Eligible individuals under the age of 75 will still be able to make non-concessional contributions to superannuation up to \$150,000 per year. Those who are under 65 can also bring forward 2 years' worth of non-concessional contributions, allowing them to contribute up to \$450,000 of non-concessional contributions in any 3-year period.

The papers state that the Government will consult on the details of the changes.

## ***Henry Report Recommendations***

The Henry Report stated that an annual cap on contributions should continue: Recommendation 18(b). There is no specific mention of a concession for people aged 50 or over making superannuation contributions. Rather, Recommendation 18 recommends that tax on super contributions be abolished and taxed in the hands of the individual, with a flat-rate refundable tax offset being available to ensure that the majority of taxpayers do not pay more than 15% on contributions.

Source: Stronger-Fairer-Simpler Fact Sheets, p 17; Henry Report Overview, p 34

## ***Government superannuation contributions for low-income earners***

From 1 July 2012, the Government will provide a contribution of up to \$500 for workers with incomes up to \$37,000. This ensures that no tax will be paid on super guarantee contributions for those with incomes up to that amount in 2012-13.

The amount payable under this measure will be calculated by applying a 15% matching rate to the concessional contributions made by or for individuals on adjusted taxable incomes of up to \$37,000, with an annual maximum amount payable of \$500 (not indexed). The amount will be paid into the individual's super fund.

Concessional superannuation contributions made from 1 July 2012 will be eligible, with the first Government contribution paid in 2013-14. The papers state that the Government will consult on the details of the changes.

Currently, all concessional superannuation contributions are taxable in the fund at a flat rate of 15%.

## Henry Report Recommendations

The Henry Report made no specific recommendation about superannuation concessions for low-income earners.

Recommendation 18 stated that:

- tax on superannuation contributions should be abolished;
- employer contributions should be treated as income in the hands of the individual and taxed at marginal rates;
- a flat-rate refundable tax offset should be available.

The Recommendation is that this offset should:

- be provided for all contributions up to an annual indexed cap of \$25,000;
- be set so that the majority of taxpayers do not pay more than 15% on their contributions;
- be doubled for people aged 50 or older;
- replace the super co-contribution and spouse contribution tax offset.

Source: Stronger-Fairer-Simpler Fact Sheets, p 13; Henry Report Overview, p 34

## INFRASTRUCTURE

### *State infrastructure funding*

A new infrastructure fund is to be established to help the States and Territories to invest in major infrastructure. This infrastructure fund will be distributed to the States and Territories in a manner which recognises that resource-rich ones face large associated infrastructure demands. Resource-rich States and Territories will receive relatively more funding which can be used to support investment in infrastructure, including that necessary for the ongoing development of the resource industry.

The final details for the infrastructure fund will be negotiated with the States. The infrastructure fund will be paid to the States each year from 2012-13 to coincide with the introduction of the RSPT (see [681] of this Bulletin). The initial total amount in 2012-13 will be \$700m.

The Henry Report simply recommended that the Australian and State governments should negotiate an appropriate inter-governmental allocation of the revenues and risks from the RSPT (Recommendation 48).

Source: Stronger-Fairer-Simpler Fact Sheets [p 7]; Henry Report Overview [p 41]

## RECOMMENDATIONS REJECTED BY GOVERNMENT

Summary of recommendations rejected by the Government

The Prime Minister and the Treasurer has stated that, in the interests of business and community certainty, the Government will NOT implement the following recommendations contained in the Henry Tax Report at any stage:

- including the family home in means tests (Recommendation 88(c));
- introducing land tax on the family home (Recommendations 52 and 53);
- requiring parents to work when their youngest child turns 4 (Recommendation 85);
- hitting single income families (Recommendation 92 and 93);
- restricting eligibility to rent assistance for families (Recommendation 103);
- making any changes to the tax system that harm the not-for-profit sector, including removing the benefit of tax concessions; raising the gift deductibility threshold or changing income tax arrangements for clubs (Recommendations 9(e), 13, 41, 43 and 44);
- reducing overall remuneration to members of the Defence Forces (Recommendations 6d, 8c and 9e);
- reducing the CGT discount, applying a discount to negative gearing deductions or changing grandfathering arrangements for GST (Recommendations 14 and 17(c));
- removing the Medicare levy (part of Recommendation 5);
- reducing indexation of the age pension (Recommendation 84);
- removing the benefits of dividend imputation (Recommendation 37);
- hitting pensioner and low income concessions for utilities, transport and other essential services (Recommendation 107);
- introducing a bequests tax (Recommendation 25);
- aligning the preservation age with the pension age (Recommendation in Australia's Future Tax System Retirement Income Strategic issues paper);
- offering a Government annuity product (Recommendation 22);
- asking the States to charge market rents to public housing recipients (Recommendation 106);
- indexing the fuel tax to the consumer price index (CPI) (Recommendation 65); and
- changing alcohol tax, that is, all alcoholic beverages should be taxed on a volumetric basis (Recommendation 71).

The Prime Minister and the Treasurer also reaffirm that the Government will never increase the rate or broaden the base of the GST, or remove tax-free superannuation payments for those over 60 years of age. According to the Hon Mr Rudd and the Hon Mr Swan, the long-term tax plan is to apply a Resource Super Profits tax to the profits earned from resources that are owned by all Australians.

The Government will use the revenue collected from the Resource Super Profits tax to:

- generate more superannuation savings for working families;
- lower tax for all companies, especially small businesses; and
- invest in Australia's future infrastructure needs, particularly for mining States.

Source: Prime Minister and Treasurer's joint media release, 2 May 2010

## OTHER HENRY RECOMMENDATIONS

Henry recommendations neither accepted nor rejected

Many of the recommendations in the Henry Tax Report were neither accepted nor rejected by the Government in its initial response. The Prime Minister and the Treasurer said that they are not Government policy and will be the subject of much debate in the coming years. These recommendations are listed below.

### *Personal income tax*

- Philosophy: progressivity in the tax and transfer system should be delivered through the personal income tax rates scale and transfer payments (Recommendation 2). The primary unit in the personal tax system should continue to be the individual, although there could be a case for optional couple assessment for people of late retirement age (Recommendation 3).
- Income support: income support and supplementary payments (eg family assistance and scholarships) should be tax-exempt (Recommendation 4).
- Dependent offsets: the existing dependant offsets should be replaced with a single dependant tax offset where the dependant is unable to work due to disability or carer responsibilities, or either the taxpayer or dependant has reached Age Pension age (Recommendation 6).
- Other tax offsets: the mature age worker, employment termination payment, overseas civilian, entrepreneurs' and notional tax offsets should be removed and the education tax refund should be replaced as part of the single family payment (but as a back-to-school lump-sum amount). The overseas forces tax offset should be replaced by adjusting remuneration to maintain net incomes. The zone tax offset should be reviewed (Recommendation 6).
- Averaging: averaging tax offsets for primary producers, the offset for "special professionals" and the lump sum payment in arrears tax offset should be retained to minimise the extent to which the timing of such income influences tax liability (Recommendation 6).
- Health costs and insurance: the medical expenses tax offset should be removed following a review of the scope and structure of health safety net arrangements. The Medicare levy surcharge and assistance for private health insurance should be reviewed. Assistance, if retained, for private health insurance should be provided exclusively as a direct premium reduction (Recommendation 7).
- Taxation of salary and wages: all forms of wages and salary for Australian resident taxpayers should be taxable on an equivalent basis and without exemptions (Recommendation 8).
- Fringe benefits: fringe benefits that are readily valued and attributable to individual employees should be taxed in the hands of employees through the PAYG system. Other fringe benefits, including those incidental to an individual's employment, should remain taxed to employers at the top marginal rate (and non-reportable for employees).

Market value should generally be used to value fringe benefits (with an appropriate adjustment for employee contributions) and the current formula for valuing car fringe benefits should be replaced

with a single statutory rate of 20 per cent, regardless of the kilometres travelled (Recommendation 9).

- FBT exemptions: all FBT exemptions should be reviewed to determine their continuing appropriateness and the not-for-profit entities' FBT concessions should be reconfigured (Recommendation 9).
- Personal services income: consideration should be given to a revised regime to prevent the alienation of personal services income that would extend to all entities earning a significant proportion of their business income from
- the personal services of their owner-managers, whether in employee-like or non-employee-like cases (Recommendation 10).
- Deductions: a standard deduction should be introduced to cover work-related expenses and the cost of managing tax affairs to simplify personal tax for most taxpayers. Taxpayers should be able to choose either to take a standard deduction or to claim actual expenses where they are above the claims threshold, with full substantiation (Recommendation 11). There should be a tighter nexus between the deductibility of the expense and its role in producing income (Recommendation 12).
- Savings income discount: provision of a 40% savings income discount to individuals for non-business related (Recommendation 14):
  - net interest income;
  - net residential rental income, including related interest expenses;
  - capital gains and losses; and
  - interest expenses related to listed shares held as non-business investments.

## **CGT**

The CGT regime should be simplified by:

- Small business CGT concessions: rationalising and streamlining the current small business capital gains tax concessions by removing the active asset 50% reduction and 15-year exemption concessions, increasing the lifetime limit of the retirement exemption (by permanently aligning it with the CGT cap for contributions to a superannuation fund) and allowing taxpayers who sell a share in a company or an interest in a trust to access the concessions via the turnover test (Recommendation 17).
- Collectables: increasing the exemption threshold for collectables and exempting all personal use assets.

## **GST**

Despite the Government's reassurance that the Henry Tax Report would not look into the GST, the Report contained various comments and one recommendation relating to it. The Report noted that while the GST is an efficient tax relative to most other taxes levied in Australia, it is less efficient than it could be because of its failure to tax consumption on a truly comprehensive basis. It also noted that complying with the GST is costly for business, especially small businesses. The Report stated that the GST "is an operationally complex tax, designed on tax invoice concepts more suited to the documentary standards of the 1960s than the digital potential of the 21st century". In relation to

the GST treatment of financial services, the Henry Report stated that the use of input taxation as a proxy for GST potentially biases production and consumption decisions.

The Report also stated that financial services should be taxed equivalently to other forms of consumption, that is, the services should be fully taxed. (Source: Henry Report Overview [pp 51-52].)

The Report recommends that the Government should consider making greater use of GST-free business-to-business transactions or reverse charging, provided the potential compliance cost savings outweigh the additional complexity costs and risks to revenue: Recommendation 56. However, the Government has neither accepted nor rejected this Recommendation.

### ***Retirement incomes***

- Superannuation fund earnings: the tax rate of super fund earnings should be halved to 7.5%, which would also apply to capital gains and the earnings from assets supporting super income streams. Superannuation funds should retain their access to imputation credits (Recommendation 19).
- Longevity insurance market: the Government should support the development of such a market within the private sector through: (i) issuing government long-term securities; (ii) providing the data needed to create and maintain a longevity index to assist product providers to hedge longevity risk; and (iii) removing rules in the Superannuation Industry (Supervision) Regulations 1994 relating to income streams that restrict product innovation (Recommendation 21).
- Increasing awareness of superannuation: awareness in super should be increased by the Government: (i)
- linking superannuation records and client identifiers (eg TFNs) to assist people to manage their superannuation (Recommendation 23(c)); and (ii) establishing a superannuation portal where people can interact with government agencies and get information on retirement incomes should be developed (Recommendation 23(d)).
- Service Pensioner preservation age: should remain at 60.

### ***Company and other investment taxes***

- Structure of company taxes: should be retained in its present form, but overseas reform trends should be monitored (Recommendation 26).
- Capital allowance rules: should be revised to closer match rates of economic depreciation and reduce administration and compliance costs. This would include: (i) immediate write-off of low-value assets (ie less than \$1,000); and (ii) reviewing agricultural and statutory effective life caps and other concessional write-off provisions (Recommendation 28).
- Small business capital allowance rules: should be revised to: (i) allow depreciating assets costing less than \$10,000 to be immediately written-off; and (ii) allow all other depreciating assets (except buildings) to be pooled together, with the value of the pool depreciated at a single declining balance rate (Recommendation 29).

- Retrospective tax losses: companies should be allowed to carry back a revenue loss to offset it against the prior year's taxable income, with the amount of any refund limited to a company's franking account balance (Recommendation 31).
- Exploration expenses: if earlier access to tax benefits from exploration expenses (relative to other expenses) is to be provided, it should take the form of a refundable tax offset at the company level for exploration expenses incurred by Australian small listed exploration companies, with the offset set at the company income tax rate (Recommendation 32).
- Interest paid to non-residents: financial institutions operating in Australia should generally not be subject to interest withholding tax on interest paid to foreign residents (Recommendation 33). Consideration should be given to negotiating in future tax treaties a reduction in interest withholding tax to zero, so long as there are appropriate safeguards to limit tax avoidance (Recommendation 34).
- Managed funds and conduit income: taxation arrangements applying to Australian managed funds should be improved to provide greater certainty that conduit income will not be subject to Australian tax.

### ***Business entities and their owners***

- Trust rules: the current trust rules should be updated and rewritten to "reduce complexity and uncertainty" (Recommendation 36).
- Flow entity regime: A flow-through entity regime for closely held companies and fixed trusts should not be adopted for now. However, consideration should be given if there is a move away from dividend imputation in the long term (Recommendation 38).
- Imputation rules: imputation credits should continue to be provided only for Australian company income tax. Dividend streaming and franking credit trading practices should, in general, continue to be prohibited (Recommendation 39).
- Harmonisation with NZ: a broad examination of the appropriate degree of harmonisation of business income tax arrangements between Australia and New Zealand should be undertaken if increased integration is desired (Recommendation 40).

### ***Not-for-profit organisations***

- Retention of concessions: categories of NFP organisations that currently receive income tax or GST concessions should retain these concessions. NFP organisations should be permitted to apply their income tax concessions to their commercial activities (Recommendation 42).

### ***State taxes and local government***

- Land tax and stamp duty: there should be no stamp duties in a modern Australian tax system. Instead, land
- tax should be levied on as broad a base as possible (eventually to include all land). However, there would be a threshold so that low-value land (such as most agricultural land) would not be subject to tax. Land tax should apply per land holding and not on an entity's total holding (Recommendations 51-54). The Government has said that these are issues for the States and Territories.

- Payroll tax: payroll tax should eventually be replaced with revenue from more efficient broad-based taxes that capture the value-add of labour (Recommendation 57).
- Co-ordination of State taxes: reforms to State taxes should be coordinated through intergovernmental agreements between the Australian government and the States to provide the States with revenue stability and to facilitate good policy outcomes (Recommendation 119).
- Local government autonomy: States should allow local governments a substantial degree of autonomy to set the tax rate applicable to property within their municipality (Recommendation 120).
- Integration of taxes: over time, State land tax and local government rates should be more integrated (Recommendation 121). This could involve:
  1. moving to a joint billing arrangement so that taxpayers receive a single assessment (but are able to identify the separate State and local component); and
  2. using the same valuation method to calculate the base for local government rates and land tax (with this method being consistent across the State).

### ***Environmental-related taxes***

- Emission reduction taxes: if a Carbon Pollution Reduction Scheme (CPRS) is operational, additional measures which seek to reduce emissions (in sectors covered by the CPRS), and which are not justified on other grounds, should be phased out (Recommendation 58).
- CPRS assistance measures: any CPRS industry assistance arrangements should be transitional. The
- Productivity Commission should be asked to undertake and publish an annual review of CPRS-related assistance arrangements for the life of the CPRS to provide a basis for future decisions on assistance policy (Recommendation 59).
- Monitoring environmental taxes: all tax concessions aimed at supporting environmental outcomes should be monitored and possibly replaced with targeted spending programs (Recommendation 60).

### ***Road transport taxes***

- Road congestion tax: congestion charges should apply to all registered vehicles using congested roads (Recommendation 61).
- Road-wear charges: the development of mass-distance-location pricing for heavy vehicles should be accelerated, to ensure that heavy vehicles pay for their specific marginal road-wear costs (Recommendation 62).
- CTP insurance: States should improve compulsory third party insurance to better reflect individual risks (Recommendation 63).
- Road freight tariffs: on routes where road freight is in direct competition with rail that is required to recover its capital costs, heavy vehicles should face an additional charge on a comparable basis, where this improves the efficient allocation of freight between transport modes (Recommendation 64).

- State revenue charges: the revenue-raising component of State taxes on motor vehicle ownership and use should be made explicit, and over time only be used to recover those costs related to road provision. The administrative costs of providing government services should be recovered through user charges where applicable. Quantity limits on taxi licences should be phased out (Recommendation 66).
- Road infrastructure: Governments should continue to reform road infrastructure provision, applying economic assessment to investments comparable to that for other forms of infrastructure (Recommendation 67). A National Road Transport Agreement should be established to determine objectives, outcomes, outputs and incentives to guide governments in the use and supply of road infrastructure. COAG should nominate a single institution to lead road tax
- reform, and ensure implementation of this agreement (Recommendation 68).

### ***Other taxes***

- Alcohol tax: a common alcohol tax should be introduced and accompanied by a review of the administration of alcohol tax, to ensure that alcohol taxpayers do not face redundant compliance obligations (Recommendation 72).
- Tobacco taxation: the existing regime for tobacco taxation in Australia should be retained, with the rates of tax substantially increased, depending on further evidence on the costs of harm from tobacco smoking (Recommendation 73). Tobacco excise should be indexed to a broad measure of wages rather than CPI (Recommendation 74). There should be no duty free allowance on tobacco for international travellers entering Australia (Recommendation 75).
- Gambling taxation: gambling taxes should be reviewed to ensure that they are focused on recouping economic rent generated by government restrictions on the supply of gambling services or are being used efficiently to impose such restrictions (Recommendation 76). Governments should eliminate gambling tax concessions for particular types of gambling business, such as clubs. If governments wish to subsidise particular types of businesses, they should do so through direct expenditures (Recommendation 77). Governments should consider the allocation of responsibilities for the regulation and taxation of gambling, with a view to minimising conflicts in policy-making between revenue-raising and addressing problem gambling (Recommendation 78).
- Rationalising other taxes: all specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption (Recommendation 79). Governments should undertake a systematic review of existing and potential user charges and minor taxes against the principles set out in this report. This should be coordinated with the introduction of the system wide Tax and Transfer Analysis Statement proposed in Recommendation 132 (Recommendation 81).

### ***Income support payments***

- Three categories of support: There should be 3 categories of income support payments.

1. A pension category for people who are not expected to support themselves through paid work, whether because of their age, disability or because they are providing full-time care for a person with disability (or frail aged).
2. A participation category for people of working age who are expected to support themselves through paid work now or in the near future. This would cover the unemployed including youth (both under and over 18), those who are temporarily incapacitated, people with a partial capacity to work and primary carers of dependent children. The rate of payment would be less than the pension rate.
3. A student assistance category for people engaged in full-time study. Students aged 21 and over would continue to be paid at a lower rate than the unemployed and at the same rate as younger students in similar circumstances.

Students could be given the ability to borrow against future income to supplement their student assistance.

- Consistent approach to payment relativities: there should be a more consistent approach to payment relativities within each of the 3 above categories of payment based on the single to couple pension relativity. A more consistent approach would mean an increase to base rates for single income support recipients in the participation and student assistance categories.
- Disability pensions: people with disability who have a partial capacity to work, excluding people receiving Disability Support Pension (DSP), should have a part-time work requirement. They should be subject to a means test or payment arrangements that provide an incentive to work part-time and that recognises that they face higher average costs of work. This could also be achieved by an in-work supplement and/or an earnings disregard in the means test (Recommendation 86).
- Student assistance: students should have access to an income test that facilitates significant part-time work at a level that does not compromise educational outcomes. Adults requiring additional income should be able to borrow to top up their student rate of income support to the level of the participation payment rate. The feasibility of using the existing income-contingent loans scheme and the potential impact of it on access to higher education of students from a low socioeconomic background should be examined (Recommendation 87).

### ***Means testing social security payments***

- Income support payments: the current income and asset tests for income support payments should be replaced with a comprehensive means test based on a combined measure of employment income, business income and deemed income on assets (Recommendation 88). The comprehensive means test would:
  - extend deemed income on assets in addition to financial assets, including superannuation income streams,
  - rental housing and other asset classes (whether income-producing or not). Superannuation income streams where deeming income would be difficult to apply would be tested on gross income but with an actuarially fair deduction for capital;
  - have low and high deeming rates based on the returns expected from a portfolio of assets held by a prudent

- investor. These rates should be set by reference to an appropriate benchmark;
  - set a high capped exemption for personal-use assets;
  - retain the current concessional treatment of employment income for certain allowances and pensions;
  - have different free areas for pensions and allowances; and
  - remove the liquid assets waiting period and the sudden-death cut-out that applies to people on certain payments.
- Family assistance payments: means testing for family assistance payments should be based on the same measure of taxable income as for income tax, including fringe benefits. However, payments should not be reduced as a result of the inclusion of compulsory superannuation contributions in taxable income (Recommendation 89).

### ***Family and youth assistance payments***

- Family Tax Benefits: current family payments, including Family Tax Benefit Parts A and B, should be replaced by a single family payment (Recommendation 90). The new family payment should:
  - cover the direct costs of children in a low-income family (that is, the costs associated with food, clothing, housing, education expenses); and
  - assist parents nurturing young children to balance work and family responsibilities.
- Introduction of per child payments: the direct cost of children component of family assistance should be a per child payment.
  - Rates of payment should increase with the age of the children to recognise the higher costs of older children. Three rates of payment should apply: for 0-11 year olds; 12-15 year olds and 16-18 year olds while in secondary
  - school. The Baby Bonus should be abolished and a small supplementary payment, reflecting the direct costs of a
  - new-born baby, should be paid over the first 3 months;
  - A shared-care rate to recognise the higher costs of separated families should be considered, taking into account
  - interactions with child support as well as other income support payments; and
  - Additional payments for larger families, including the Large Family Supplement, the Multiple Birth Allowance for children over one year, and higher thresholds for larger families should be reconsidered as the case for these payments is not strong.
- Parental supplement: for couples with children aged 6 or older, a parental supplement at the same rate as for single parents should be paid through the income support system (Recommendation 94).
- Disabled or foster care children: assistance for families should also recognise that there are specific circumstances, such as parents caring for disabled children and foster care children with higher needs, for which additional support beyond the early years is appropriate (Recommendation 95).
- Means testing withdrawal rate: the total amount of family assistance should be withdrawn with a single means test to avoid cumulative withdrawal rates which create unnecessarily

high disincentives for working. A single low withdrawal rate of 15-20% would be appropriate to minimise workforce disincentives (Recommendation 96).

- Youth payments: while family payments should be the main form of assistance for families with children up to the end of secondary school, or the school year in which they turn 18 (the earlier of the 2), youth payments should be available to older children in some circumstances:
  - dependent older children for whom a suitable pathway may be leaving school and looking for work or combining part-time work and part-time study should have access to a youth payment, governed by strict participation requirements; and
  - children without access to financial support from their families should continue to have access to a youth payment, governed by strict criteria (Recommendation 98).
- Youth payments should be the main form of income support from the age of 18 until the age of independence (Recommendation 98).

### ***Child care assistance***

- Child Care Benefit and Child Care Rebate: the Benefit and the Rebate should be combined into a single payment to parents (or to child care centres) in respect of each child based on a percentage of child care costs (Recommendation 99). The payment should have the following features:
  1. a high rate of subsidy for low-income families that covers most of the costs of child care (up to 90%);
  2. a base rate of assistance for all families that use child care to facilitate parental engagement in the workforce;
  3. access to the base rate of assistance subject to a requirement that parents participate in work, education or training; and
  4. coverage of the full costs of child care for at-risk children and children facing multiple disadvantages, without participation requirements on parents.
- Means testing child care payment: the child care payment should be means tested down to the base rate of assistance based on family income and should have regard to the interaction with other means tested payments (income support and family payments) and marginal tax rates (Recommendation 100).
- FBT exemptions: the fringe benefits tax exemption for child care facilities provided on an employer's business premises for the benefit of employees should be removed (Recommendation 101).

### ***Housing assistance***

- Rent assistance: the maximum rate of Rent Assistance should be increased to assist renters to afford an adequate standard of dwelling. To ensure that Rent Assistance can be maintained at an adequate level over time, the rent maximum should be indexed by movements in national rents, which could be measured by an index of rents paid by income support recipients (Recommendation 102).

- Public housing tenants: mechanisms should be developed to extend Rent Assistance equitably to public housing tenants along with removing income-linked rent setting in public housing (Recommendation 104).
- High-need housing payment: a high-need housing payment should be paid to social housing providers for their tenants who have high or special housing needs or who may face discrimination in the private market. This payment should be funded by the Australian government. The Commonwealth and the States should retain the option of providing capital for social housing construction (Recommendation 105)

### ***Productivity Commission***

- Public service delivery: the Productivity Commission should examine the principles of public service delivery and the mechanisms that are available to governments to deliver public services and their implications for financial arrangements in the federation (Recommendation 108).

### ***Funding aged care***

- User-directed funding: there is considerable scope to align aged care assistance with the principles of userdirected funding to provide assistance in line with recipients' needs, enable their choice of care and support the fiscal sustainability of the aged care sector (Recommendation 109).
- Role of insurance in aged care: The Productivity Commission will be inquiring into the disability insurance scheme, and its consideration of aged care should include the potential for insurance to play a role in helping to fund aged care as Australia's population ages (Recommendation 110).

### ***Housing affordability***

- Institutional arrangements: Governments should review institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability (Recommendation 69).
- Infrastructure arrangements: infrastructure charges (or developer charges) should be reviewed to ensure they appropriately price infrastructure provided in housing developments. This should establish practical means to ensure that these changes are set appropriately to reflect the avoidable costs of development, necessary steps to improve the transparency of charging and any consequential reductions in regulations (Recommendation 70).

### ***A responsive and accountable tax system***

- Community input: the Government should establish a more transparent means of dealing with community
- ideas about the tax system by extending the Tax Issues Entry System website and further developing its use (Recommendation 111).
- Tax law design: the Government should commit to a principles-based approach to tax law design as a way of

- addressing the growing volume and complexity of tax legislation, and as a way of helping those laws to be interpreted consistently with their policy objectives (Recommendation 112).
- Board of Taxation: the Board of Taxation should be empowered to initiate its own reviews of how current tax policies and laws are operating, in consultation with the government. This would be in addition to reviewing matters referred to it by the government, though it should not engage in substantive policy development unless requested by the government (Recommendation 113).
- Freedom of Information: information or advice provided by Treasury to assist the ATO in determining the purpose or object of the law, or materials used by the ATO to determine policy intent (other than correspondence with or from government) should be made public (Recommendation 114).
- Managing the Tax Office: a board should be established to advise the Commissioner on the general organization and management of the ATO. The board would not be a decision-making body and would have no role in interpreting the tax laws or examining individual taxpayer issues. The government would appoint members to the board (Recommendation 115).
- Role of Inspector-General of Taxation: the Government should clarify that the role of the Inspector-General of Taxation is to examine systemic tax administration issues that affect businesses (Recommendation 116).
- Funding for review bodies: the Government should ensure that sufficient resources are devoted to the functions of the Inspector-General of Taxation, the Australian National Audit Office and the Commonwealth Ombudsman (Recommendation 117).
- Implementation of recommendations: the Joint Committee of Public Accounts and Audit should examine reports of the Inspector-General of Taxation and the Commonwealth Ombudsman, and monitor the ATO's implementation of the recommendations in those reports (Recommendation 118).

### ***Customer service: tax and social security***

- Tax and transfer client account: a tax and transfer client account should be developed, based on customer research and with customer input into its design (Recommendation 122). The account should include at least the following features:
  - o up-to-date presentation of income earned from all sources, taxes withheld, tax liabilities incurred, transfers received and information flows from third parties;
  - o complete information from past periods;
  - o an optional single point for updating personal information, undertaking transactions, and reporting information or making applications, with extensive pre-filling of forms based on information previously provided; and
  - o the ability to test the impact of hypothetical changes in circumstances.
- Pre-filled income tax returns: pre-filled personal income tax returns should be provided to most personal taxpayers as a default method of settling their tax affairs each year (Recommendation 123).

- Impact of changes on stakeholders: existing tax and transfer provisions should be reformed to support improvements in client experience, including greater alignment of income definitions and reporting, rationalising of personal tax deductions and offsets, and streamlining of mandatory administrative requirements. Future new policy proposals should be subject to comprehensive, published expected impact assessments on client experience systems and outcomes (Recommendation 124).
- Third party data: where possible, information required for determining tax liabilities and transfer entitlements should be collected from third parties, including employers, government agencies, financial institutions, and share and property registries. Over time, electronic provision of this information by third parties should be made mandatory. To reduce current and minimise new compliance costs, reporting obligations should as far as possible be aligned with existing information concepts and systems of third parties, and facilitated through electronic interaction with information held in the “natural systems” of those entities (Recommendation 125).
- Impact of compliance costs: further approaches (extension to and approaches which build on Standard Business Reporting) should be pursued to reduce the compliance costs associated with business interactions with government (Recommendation 126).
- Small business preparedness: the Government should assist small businesses to be “business ready” when they begin business. This could be achieved through education and financial assistance, which may include assistance to small business to get ready for Standard Business Reporting (SBR) (Recommendation 127).
- Common information standards: common information standards, leveraging from the standards and governance put in place by the SBR Program, be developed and adopted to support system interoperability between tax and transfer agencies, and between those agencies and third parties, such as employers (Recommendation 128).
- Privacy concerns: a modern privacy and secrecy framework be developed and adopted that maintains and streamlines protection of personal information held by government agencies, and facilitates exchange of information (other than an individual’s health information) between agencies to support improved client experience of the tax and transfer system (Recommendation 129).
- Linking records: a method of linking records, eg by linking existing client identifiers, be developed to facilitate development of a single client account for tax and transfer financial information (Recommendation 131).
- High level taskforce: a high level taskforce should be established, under central agency leadership, to progress a whole of government approach to improving the client experience of the tax and transfer system. The taskforce should develop, consult, oversee and regularly report to government and Parliament on a whole-of-system reform of the administrative arrangements and technologies that deliver the client experience of the tax and transfer system.

### ***Monitoring the tax system***

The Henry Report made various recommendations on monitoring the tax system, including (Recommendations 132- 138):

Sydney  
GPO Box 5360  
Sydney NSW 2001

Level 32, 1 Market Street  
Sydney NSW 2000  
tel 02 9299 8666  
fax 02 9299 6636

email [office@cdtl.com.au](mailto:office@cdtl.com.au)  
ABN: 86 317 736 260

Brisbane  
GPO Box 1092  
Brisbane QLD 4001

Level 22, 127 Creek Street  
Brisbane QLD 4000  
tel 07 3218 2134  
fax 07 3218 7377

Liability limited by a scheme approved under Professional Standards Legislation

- the Australian Government should publish every 5 years a statement that analyses and reports on the overall
- performance and impact of the system, including estimates of efficiency costs and distributional impacts (Recommendation 132);
- the Australian and the State governments should systematically collect data on aspects of existing taxes and transfers (Recommendation 133);
- the Australian Government should ensure that the rules governing the development of the Budget encourage trade-offs between tax expenditures and spending programs;
- the Government should ensure that reporting standards are independently developed for the identification and measurement of tax expenditures in the Tax Expenditures Statement; and
- the Council of Australian Governments should examine the ways in which the States could uniformly report tax expenditures annually according to those reporting standards.

Source: Stronger-Fairer-Simpler Fact Sheets, p 17; Henry Report Overview, p 34

### **Disclaimers**

*This is an initiative of, and has been prepared by CDTL. While every effort has been made to ensure the accuracy of the information contained therein, CDTL Partners nor its employees shall be liable on any grounds whatsoever in respect of decisions or actions taken as a result of using this publication. The information provided is a general guide only and should not be used, relied on or treated as a substitute for specific professional advice or referral to the relevant specific standard.*