



# 2010

**PKF**

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## Henry Tax Review – a work in progress

The Henry Tax Review was commissioned to consider the possibilities for Australia's future tax system. The Government has now released the Committee's Report, which has 138 recommendations for possible changes and enhancements to Australia's Tax System. The Report is an extensive and far reaching document but will only be implemented if and when the Government decides to do so, probably over the next 10 years or so.

## Government's Response – Tax Resources

### Resources tax to pay for superannuation, and small business concessions and company tax cut

In the first wave of a 10 year agenda the Government proposes to introduce a Resources Super Profits Tax to fund concessions for company and small business taxes, and superannuation. Other proposals being considered by the Government include making tax time simpler and improving incentives to save. The Government has also announced the recommendations which they have specifically rejected and will not implement at any stage.

### Company tax rate reduced

In response to the Henry Report recommendation to reduce the company tax rate to 25%, the Government has proposed the company tax rate be reduced from 30% to 28% in two stages starting from July 2013. However, for eligible small business companies the 28% rate will apply from 1 July 2012. The rates will occur in two stages as follows:

Income year	Normal company tax rate	Small business rate
2011-12 (i.e. Current tax rate)	30%	30%
2012-13	30%	28%
2013-14	29%	28%
2014-15	28%	28%

The reduction in the company tax rate will be funded through the introduction of the proposed Resources Super Profits Tax.

At this stage the Government has not indicated what companies will qualify as "eligible small business entities", however they are expected to consult on the implementation details of this measure before preparing exposure draft legislation.

## Small business immediate asset write-off

The existing capital allowance deductions available for small businesses will be expanded. From 1 July 2012, small businesses will be allowed:

- an immediate deduction for assets valued at less than \$5,000 (currently \$1,000); and
- a deduction for all other assets valued at \$5,000 or more (except buildings) by including them in a single depreciation pool at a rate of 30% per annum. Currently, assets can be allocated to two different pools according to their effective life – i.e. a general pool at a diminishing value rate of 30% per annum or a long-life pool at a diminishing rate of 5% per annum.

## Superannuation changes

### Super guarantee rate increase

Despite no specific recommendation about the super guarantee rate in the Henry Report, the Government is proposing to gradually increase the rate from 9% to 12%, phasing the increase in from 1 July 2013. This will be achieved by increasing the percentage by 0.25% per year in the first two years and 0.5% thereafter.

### Super guarantee increases

Year commencing	Super guarantee rate
1 July 2012 (i.e. current rate)	9%
1 July 2013	9.25%
1 July 2014	9.5%
1 July 2015	10%
1 July 2016	10.5%
1 July 2017	11%
1 July 2018	11.5%
1 July 2019	12%

### Super guarantee age limit raised

In line with the Committee's recommendation, the Government is proposing to increase the super guarantee age limit from 70 to 75, with effect from 1 July 2013. Consequently, contributions will need to be made up until an employee turns 75 years of age.

Currently, the super guarantee only applies to people aged up to 70 years but employers can make voluntary deductible contributions for employees under the age of 75. Self-employed people can make deductible contributions until the age of 75.

### Concessional contributions caps to continue

From 1 July 2012 onwards, individuals aged 50 and over with total superannuation balances below \$500,000 will be able to make up to \$50,000 in concessional super contributions. This extends the \$50,000 cap that was due to expire on 30 June 2012 and doubles the cap of \$25,000 which is scheduled to apply from 1 July 2012.

Individuals under 75 years of age will still be able to make non-concessional super contributions up to \$150,000 per year. Individuals under 65 years of age can also bring forward two years' worth of non-concessional contributions, allowing them to contribute up to \$450,000 of non-concessional contributions in any three-year period.

### \$500 Government super contributions

From 1 July 2012 the Government will provide a super contribution of up to \$500 annually for individuals earning up to \$37,000. The amount will be paid into the individual's super fund. The amount payable will be calculated by applying a 15% matching rate to the concessional contributions made by or for the individual. This means concessional contributions made from 1 July 2012 will be eligible for the first Government contribution to be paid in 2013-14.

Currently all concessional super contributions are taxable in the fund at a flat rate of 15%. This measure ensures no tax will be paid on super guarantee contributions for individuals with incomes up to \$37,000 in the 2012-13 year.

## Resource Super Profits Tax introduced

To fund the above concessions the Government will implement the Committee's proposal to introduce increased taxation for the resources sector.

### Resource Super Profits Tax (RSPT)

The Government proposes to introduce on 1 July 2012 a Resource Super Profits Tax at the rate of 40% on profits made from the exploration of Australia's non-renewable resources. The RSPT will apply to all legal entities including companies, partnerships and trusts.

The announcement to introduce a RSPT is generally consistent with the recommendations of the Committee. The RSPT will be imposed at 40% on a taxable amount derived after taking into account extraction costs and an appropriate recoupment of capital investment (proposed to be the 10 year bond rate).

### Credit for State Royalties

Where State based royalties are paid the taxpayer will be entitled to a refundable credit for the State royalties, but it will be capped to the current royalty rate, including scheduled increases.

### Losses

The Government has agreed to the Committee's proposal to allow a transfer of RSPT losses to group owned resource projects or allow the losses to be compounded and carried forward for use against future income. Where the losses cannot be used in this way, the tax value of residual losses is to be refunded on closure of the project.

### RSPT Interaction with Income Tax

RSPT payments will be deductible for income tax purposes. In addition RSPT refunds will be assessable for income tax purposes.

### Transfer pricing

One of the challenges under the existing Petroleum Resource Rent Tax (PRRT) is the tax value of product when it is sold at a point later than when the product is produced (such as where there is secondary treatment undertaken). The PRRT requires a transfer price to be calculated.

The Committee recognised the need for such a transfer pricing mechanism and the Government has accepted the need to consult with industry in this regard.



### Boundary issues – costs

One of the emerging issues under the PRRT is referred to as “boundary issue” - what costs are included in the deductible pools and what are too remote to be included in the deductible pools. The Committee noted the following costs would not be included in the deductible pool:

- ▶ interest and borrowing costs;
- ▶ dividends and the cost of issuing shares;
- ▶ repayments of equity;
- ▶ payments to acquire interests in permits, production licences or access authorities;
- ▶ payments to acquire interests in projects subject to the tax;
- ▶ payments of income tax or GST; and
- ▶ payments of administrative or accounting costs incurred indirectly with the carrying on of a project.

The Committee also noted the treatment of royalties paid to indigenous groups would require further consideration.

## Coverage of the regime

The Government announced the regime will cover all extractive industries without exemptions, including existing projects except for taxpayers subject to the (PRRT).

The Government has announced taxpayers with existing petroleum projects currently subject to PRRT will be given the option to bring those projects within the new RSPT.

## Cash bidding

The Committee recommended a cash bidding system should be implemented to allocate exploration permits except in small exploration areas where there are unlikely to be net benefits from cash bidding. In this case, a first come first served process should be used.

## State vs Commonwealth

The Committee made two recommendations:

- ▶ abolish State royalties - the Federal Government assign RSPT revenue to the States; or
- ▶ credit State royalty payments against RSPT.

The Government announced State royalties will be refunded as a tax credit to companies.

## Henry Recommendations That Will Not Proceed

The Government announced it will not implement the following policies at any stage:

- ▶ include the family home in means tests;
- ▶ introduce land tax on the family home – this is a State tax and thus an issue for the States;
- ▶ require parents to work when their youngest child turns four;
- ▶ hit single income families;
- ▶ restrict eligibility to rent assistance for families;
- ▶ make 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;
- ▶ reduce overall remuneration to the members of our defence forces;
- ▶ reduce the capital gains tax discount, apply a discount to negative gearing deductions, or change grandfathering arrangements for capital gains tax;
- ▶ remove the Medicare levy;
- ▶ reduce indexation of the age pension;
- ▶ remove the benefits of dividend imputation;
- ▶ reduce pensioner and low income concessions for utilities, transport and other essential services;
- ▶ introduce a bequests tax;
- ▶ align preservation age with pension age;
- ▶ offer a government annuity product;
- ▶ ask the States to charge market rents to public housing recipients;
- ▶ abolish the luxury car tax;
- ▶ index fuel tax to CPI; or
- ▶ change alcohol tax in the middle of a wine glut and where there is an industry restructure underway.



# Summary of Henry Recommendations

The Henry Review was predicated on the basis the Australian tax system should support the development of the economy by encouraging:

- ▶ workforce participation;
- ▶ a more efficient pattern of saving;
- ▶ investment in education and physical capital;
- ▶ structural change; and
- ▶ sustainable economic activity.

The Committee based its recommendations on nine themes which they felt should drive the future architecture of the tax system. These themes are discussed and expanded on below.

## Concentrating revenue on four efficient tax bases

The Australian tax system has too many taxes resulting in an excessively complex system. From an economist's perspective, the system is neither efficient nor effective, and rationalisation is a priority. To achieve this, the Committee recommended:

- ▶ revenue be concentrated on four bases:
  1. comprehensive personal income;
  2. business income (growth oriented);
  3. broad, simple private consumption; and
  4. comprehensive economic rents from natural resources and land;
- ▶ maintain other taxes, such as taxes on tobacco, gambling, alcohol and road user charges only if they efficiently address social or economic costs; and
- ▶ abolish inefficient taxes, such as insurance taxes, payroll tax, stamp duty, luxury car tax, and taxes on superannuation contributions.



## Configuring taxes and transfers to support productivity, participation and growth

The Committee cites tax theory and research as evidence that the architecture of the tax and transfer system has a major effect on long-term growth, workforce participation, productivity and investment. The Committee recommends the architecture of the system be restructured to positively influence these issues by:

- ▶ reducing the company tax rate to 25% over the medium term;
- ▶ in the long term consider replacing company income tax with a tax on business expenditure;
- ▶ retaining dividend imputation for the short to medium term but considering alternatives in the longer term;
- ▶ improving support for child care and building work incentives into income support payments in order to promote workforce participation; and
- ▶ improving productivity through more efficient taxes, including:
  - improved treatment of business losses, including one year carry back;
  - streamlined and enhanced capital allowances; and
  - a common 40% discount for interest, residential rents and capital gains for personal savings.

## An equitable, transparent and simplified personal income tax

The Committee recognises personal income tax will remain the largest source of revenue, as well as recommending it be the sole means of distributing progressivity in the tax system. However, the system is too complex and it should be simplified on the following basis:

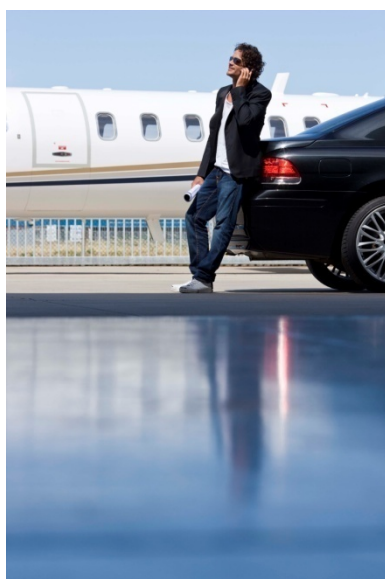
- ▶ increase the tax free threshold (\$25,000) with a two-step tax scale;
- ▶ work related deductions – provide an optional standard deduction amount that can be claimed instead of claiming actual expenses;
- ▶ include reportable fringe benefits, in personal income tax returns;
- ▶ all pensions, allowances and transfer payments should be tax free;
- ▶ Medicare levy and low income, senior Australian, pensioner and beneficiary tax offsets to be incorporated into the income tax rate; and
- ▶ remove various other tax offsets including the medical expenses offset, employment termination offset and entrepreneur's offset.

## Fringe benefits

As mentioned above, employee fringe benefits that can be attributable to specific employees should be taxed to the employee through the PAYG system. Other fringe benefits would be taxed to the employer.

The various statutory formula rates for motor vehicle fringe benefits should be replaced with a single statutory rate of 20%.

All fringe benefits tax concessions should be reviewed for their appropriateness.



## A fair, adequate and work supportive transfer system

In addition to addressing the tax system, the Committee made the following comments on aligning the transfer system:

- ▶ establish three levels of primary support payments:
  - pensions for the aged, disabled and carers;
  - lower participation allowances for those of working age; and
  - assistance payments for young people and students;
- ▶ all payments to be indexed;
- ▶ improve relativity for single and couple payments; and
- ▶ abolish the assets test and replace all means tests with a standardised means test.

## Capital gains tax

- ▶ Pre-capital gains tax (CGT) exemption be removed, with all pre-CGT assets to obtain a market value cost base at the time the exemption is removed.
- ▶ Small business CGT be rationalised and streamlined by removing the active asset 50% reduction and the 15 year exemption but increasing the lifetime limit for the retirement exemption.

## Personal services income regime

Extend the personal services regime for all entities earning a significant portion of their income from personal services of owner managers.

## Company and business taxation

- ▶ Tax losses carry back for one year. Currently tax losses can only be carried forward. Under the proposal, companies would be able to amend the previous year tax return to claim tax losses made in the current year.
- ▶ The Committee recommended assets costing less than \$1,000 be immediately written off and the threshold for small business to be raised to \$10,000 for immediate write off.
- ▶ In the longer term, consider a flow through entity regime for closely held companies and fixed trusts but only if there is a move away from dividend imputation.

- ▶ Interest paid to non-residents by financial institutions to be exempt from non-resident withholding tax.
- ▶ Increased integration of the Australian and New Zealand business income tax arrangements.

## Trusts

The current trust rules should be updated and rewritten.

## Integrating consumption tax compliance with business systems

The Committee recognised the system of State based taxes is inefficient. It noted a tax on consumption is an efficient and robust tax base, although the GST is a complex tax which is based on 1960s concepts. In particular, the Committee recommended:

- ▶ replace the narrow State taxes base with a low rate, broad cash flow tax; and
- ▶ replace the current inefficient input taxation of financial services under the GST with a more efficient financial services tax.

## Efficient land and resource taxation

The Committee notes that returns to immobile factors such as land and natural resources represent an efficient tax base. In support of these contentions, the Committee recommended:

- ▶ replacing existing resources royalties (other than low value commodities) with a resources rent tax of 40%;
- ▶ natural resource exploration expenses allowed as a refundable tax offset to allow tax benefits from exploration to be obtained earlier;
- ▶ introduce a symmetrical treatment of losses based on capital allowances;
- ▶ transition the new rules for new and existing projects; and
- ▶ replace the existing land tax with a land tax applying to all land regardless of use, subject to tax on the value (per square metre) of the land. This would generally exempt agricultural land and tax residential land at 1%.

## Completing retirement income reform and securing aged care

The Committee made these comments:

- ▶ the tax on superannuation fund contributions should be abolished;
- ▶ contributions should be included in the employee's assessable income;
- ▶ assessable income and capital gains of funds should be taxed at 7.5%;
- ▶ continue the \$50,000 transitional cap for those aged 50 and over; and
- ▶ longevity insurance products should be encouraged, including by the Government.

## Toward more affordable housing

The Committee noted housing affordability has deteriorated in recent years, and made the following recommendations:

- ▶ increase rental assistance for those on income support;
- ▶ market rents on public housing, with income assistance more targeted;
- ▶ introduce land tax on all land;
- ▶ remove transfer taxes on property; and
- ▶ 40% discount on all residential rental income and capital gains.



## A more open, understandable and responsive tax system

The Committee recommends the tax system become more responsive to taxpayers as well as more responsive to integrity issues:

- ▶ taxpayers access comprehensive and timely information on their tax and transfer affairs;
- ▶ Board of Taxation empowered to review operation of tax laws; and
- ▶ devote more resources to Inspector-General of Taxation, National Audit Office and the Ombudsman.

## Road transport taxes

- ▶ Road user charges should be applied for use of heavily congested parts of the road network by extending existing technologies and new technologies to identify the vehicles using particular roads.
- ▶ Road taxes should be used specifically for maintenance and upgrading the road transport system.

## Alcohol taxes

Alcohol taxes should be rationalised with the tax to be based on the alcoholic volume in the beverage, with a low-alcohol threshold for all products. The tax should be based on the net cost to the community of use of alcohol.

Should you require assistance or additional information, **please contact your PKF Tax Adviser** or:

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