Tax and Superannuation Update – Henry Review May 2010

Stronger, Fairer, Simpler – A Tax Plan for our Future

On 2 May 2010 the highly anticipated Henry Taxation Review was released to the public, along with the Federal Government's response.

The Henry Review panel released 138 recommendations, of which the Government addressed less than 50 in it's new tax initiative "Stronger, Fairer, Simpler – A Tax Plan for our Future". Most of the new tax initiatives will commence to be implemented from 1 July 2012. We outline below some of the proposed changes in the Government's new tax initiative:

Changes to Superannuation

The Henry Review panel made numerous recommendations with respect to superannuation, however the Government did not adopt any of the proposals. Rather, the following changes were announced:

- Increasing the superannuation guarantee rate to 12% from 1 July 2013 to 30 June 2019;
- Increasing the age at which employers are obligated to make superannuation guarantee contributions from age 70 to age 75 from 1 July 2012;
- Retaining a higher concessional contribution cap for people over age 50 from 1 July 2012 of $50,000 per annum provided the member has less than $500,000 in their superannuation balance
- Providing a Government superannuation contribution of up to $500 from 1 July 2012 to workers whose adjusted taxable income is less than $37,000 to offset any contributions tax on superannuation guarantee.

Company Tax, Small Businesses & Entities

The recommendations made by the panel with respect to company tax and small businesses were considered by the Government, with some of the recommendations included in some form in the new initiative:

- The Review proposed a cut in the company tax rate to 25% in the short-term. The Government has proposed a reduction in the company tax rate to 29% in 2013/2014, further reducing to 28% in 2014/2015. The reduced 28% tax rate would apply to small businesses from 1 July 2012;
- A recommendation was made to provide an immediate write-off for small businesses for assets costing $10,000 or less. The Government has proposed that this apply to assets costing less than $5,000 from 1 July 2012, and has also proposed allowing small businesses to write-off other assets (excluding buildings) in a single depreciation pool at a 30% rate;
- Although not specifically recommended, the Review did state that the dividend imputation system should be reviewed in detail in light of other company tax changes. This recommendation was rejected by the Government;

- The Review recommended that the laws with respect to trusts be updated and rewritten to reduce their complexity and uncertainty. No comment was made on this recommendation by the Government.

Resource Industry

The worst kept secret with respect to the Review was the introduction of a Resource Rent Tax (RRT), which the Government has now named a Resource Super Profits Tax (or RSPT):

- The Review proposed a RRT of 40%, to be revised in line with company tax rates. The intention of the RRT was to achieve a combined tax rate of 55%;
- The Government initiative is the introduction of a RSPT, with the rate set at 40%. This rate would apply to super profits made from all non-renewable resources from 1 July 2012;
- RSPT liabilities will be deductible, with any RSPT refunds being assessable for income tax purposes;
- A five year phase in period would apply from 1 July 2012, with companies with existing projects in place prior to that time having access to accelerated depreciation, as well as receiving full recognition for the book value of existing projects;
- As the RSPT is designed to replace any State royalties, some negotiation will be required between the State and Federal Governments with respect to the revenue earned;
- If States continue to impose their own royalties, an offset would be available to companies to ensure they are not paying double tax;
- The taxing point for RSPT will be as close to extraction as possible, however extensive consultation from stakeholders is expected to ensure a suitable methodology;
- The RSPT would pay for many of the proposals in the Government's new tax initiative, including the intended infrastructure fund, whose main purpose is to provide targeted funding to resource rich areas, as well as the superannuation tax concessions.

Although the Government is imposing the RSPT to provide a more "appropriate return to the Australian community from the exploitation of its non renewable resources compared with the current charging arrangements", they are also ensuring that new exploration and development is encouraged by providing a Resource Exploration Rebate at the company tax rate for eligible exploration expenses incurred after 1 July 2011:

- This rebate will be a refundable offset to companies, which means that they don't have to wait until they generate a profit to use the offset;
- The rebate will be available to all companies, not just "small listed companies";
- The definition of exploration will be extended to also include exploring for geothermal energy.

Recommendations Rejected

Components of the Review and the Government's response that were of interest were those recommendations that the Government has completely rejected in the "interests of business and community certainty". These include:

- Changes to the dividend imputation system;
- Changing the CGT regime by reducing the CGT discount, applying a discount to negative gearing deductions and removing the grandfathering available for pre 1985 assets;
- Including the family home in means testing;
- Introducing land tax on the family home;
- Reducing concessions available to the not-for-profit sector, including with respect to FBT;
- Removing the Medicare Levy;
- Abolishing the luxury car tax;
- Introducing a wealth transfer / bequests tax;
- Offering a Government annuity product;
- Index fuel tax to CPI;
- Requiring parents to work at least part-time upon their child attaining age 4 to retain family tax benefits and income support payments;
- Increasing the preservation age with respect to superannuation to bring it in line with Age Pension Age.

The Government also confirmed that they would never increase the rate or broaden the base of the GST, or remove the tax-free status of superannuation payments for taxpayers over age 60, which were specifically excluded from the terms of reference for the Review.

Other Recommendations

The Government's tax initiative only addressed a proportion of the Review's recommendations, although they have stated that further announcements could be forthcoming in next week's Budget. Recommendations made by the Review panel that were not addressed by the Government but may yet be introduced include:

- Changes to the personal tax regime, with the main theme to make it easier for individuals to manage their tax affairs and increase the equity.
  - All forms of salary and wage income should be taxed on an equivalent basis, regardless of its source (for example foreign income, defence force personnel);
  - Attribution of the taxation of some fringe benefits directly to the employee rather than the employer;
  - Providing a 40% savings income discount to individuals who earn passive income from investments (for example, interest on bank accounts);
  - The nexus between the deductibility of expenses and the earning of assessable income should be tightened;

- Extending the Personal Services Income regime to all entities earning a substantial portion of income from the personal services of the owner / manager, as well as imposing an arm's length rule to deductions.
- Making changes to the small business CGT concessions to remove the active assets 50% discount and 15 year exemption, whilst increasing the retirement exemption amount;
- Review of the Fringe Benefits Tax regime with a focus on reviewing current exemptions and consideration of simplifying the valuation of car fringe benefits;
- Simplification of the preparation of individuals' Income Tax Returns through a greater reliance of pre fill information;
- Moving toward a standardised work deduction regime, which would reduce the substantiation requirements currently in place;
- Increasing the small business turnover test from $2M to $5M, as well as making adjustments to the $6M net asset value test for eligibility for small business CGT concessions;
- Implementing some of the recommendations with respect to superannuation:
  - Imposing a taxpayer's marginal tax rate on contributions to superannuation, with an offset available for contributions up to $25,000 ($50,000 for those over 50) to cap the tax payable at 15%;
  - Reducing the earnings tax rate within superannuation funds to 7.5%, with capital gains receiving no discount. This rate would apply universally, so there would be no exemption for assets supporting an income stream. Fund's would retain their eligibility to receive a refund of franking credits;
  - Removing the restriction on taxpayers over age 75 from contributing to superannuation. A work test would still be applicable for those over 65;
- Rationalisation of the various tax offsets available to individuals to simplify the current arrangements;
- Making income support payments tax exempt;
- Changing the child care arrangements such that parents receive a single payment based on a percentage of child care costs, with a means test applicable;
- Imposing a congestion based tax on existing toll roads, as well as a usage based tax on heavy vehicles to cover the cost of road-wear and maintenance of specific roads.

We await any further announcements with respect to the above recommendations, which may not be forthcoming until after the election.

Our Views

The Recommendations made in the Henry Review are of interest to future tax reform. However, the Government's initial response and new tax initiative are underwhelming, particularly given the hype in the lead up to the release of the report.

Due to the fact that it is an election year, it is not surprising that many of the unpopular recommendations have not been included in the initiative, although by not commenting on some of them there remains the potential for future changes. This is disappointing, as it creates uncertainty and reduces the integrity of the Australian Tax System. However, providing a comprehensive list of rejected recommendations does provide an element of certainty to future reforms in some areas.

The Next Step

Given the fact that further announcements may be forthcoming next week, there is still some uncertainty with respect to other tax reform the Government may introduce. As most of the initiatives are due for implementation from 1 July 2012 at the earliest, there is lead time available to implement any changes that affect you. As the consultation process continues and legislation is introduced, we will keep you up to date on any developments as they come to hand.

If you have any queries, or would like advice in relation to any matters relating to any of the above, please contact either Michelle Saunders, Marissa Bechta or Jemma Sanderson on (08) 6311 6900.

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