



UNDERSTANDING THE HENRY REVIEW

The Government's response to the
Henry Review into Australia's Future Tax System

Phase 1

2 May 2010

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AUSTRALIA'S FUTURE TAX SYSTEM – DRIP FED REFORM

Phase 1

In the days leading up to the release of the Government's response to the Henry Review into the Future of Australia's Tax System, the review was predicted to herald sweeping changes to almost every aspect of taxation from individual tax returns to a resolution to the ongoing tensions between State and Federal taxes.

The reality? The reforms released at the beginning of May are only part of the picture and focus exclusively on resource, company and small business taxation. Many of these reforms are also so far away as to make their certainty unpredictable. Complicating this is the fact that all of the reforms are reliant on the Government being able to successfully pass a 40% profits tax on the resources sector.

Some of the more aggressive reforms and those likely to have an immediate budgetary impact are yet to be acted upon. We will anxiously await the Federal Budget on 11 May to see what it contains (or perhaps the post election Budget). Releasing the reforms Treasurer Wayne Swan stated that over the coming months "...we will have more to say on a number of other areas considered by the review, especially making tax time simpler for everyday Australians, improving incentives to save and improving the governance and transparency of the tax system."

The reforms contained in the first wave of the Henry Review recommendations adopted by Government are funded by a Resource Super Profits Tax that capitalises on the resources boom and will see the Government increase its share from this sector to around \$9 billion (assuming that the estimates used to calculate the tax take are accurate).

Other reforms include a reduction to the company tax rate to 28% by the 2014/2015 financial year (2012/2013 for small business), an increase to the superannuation guarantee to 12% by 2019/2020, and accelerated and simplified depreciation for small business by 2012/2013.

At no point should you act on the reform announcements until they become law. We will work with you to help you navigate the changes as they apply to your individual circumstances.

If you have any questions or concerns about the impact of the announced changes on you or your business, please contact us.

REFORMS AND IMPLEMENTATION TIMETABLE

Reform area	Reform	Est implementation date
Company tax	Phased reduction in the company tax rate to 28% in 2014/2015	1 July 2013
Company tax (small business entities)	Reduction in the company tax rate to 28% for small business from 2012/2013	1 July 2012
Small business depreciation	Instant asset write off and simplified depreciation – expands the capital allowance concessions available for small business entities	1 July 2012
Superannuation guarantee	Incremental increases to super guarantee each financial year to reach 12% by 2019/2020	1 July 2013
Superannuation guarantee	Superannuation guarantee age limit increased to 75	1 July 2013
Superannuation concessional contributions caps	A higher ‘catch up’ contribution cap of \$50,000 for those 50 and over with super balances less than \$500k	1 July 2012
Superannuation – low income earners	A superannuation contribution from the government of up to \$500 pa for those on adjusted taxable incomes up to \$37k	Contributions made from 1 July 2012 (paid in 2013/2014)
Resource profits tax	40% profits tax on non-renewable resources (Resource Super Profits Tax or RSPT)	1 July 2012
Resource exploration rebate	Refundable tax offset set at the company tax rate for exploration expenditure in Australia	Exploration expenditure on or after 1 July 2011
Infrastructure fund	\$700 m fund to be divided up among the states. Derived from the RSPT	2012/2013

THE REFORMS IN MORE DETAIL

1. Reduction in the company tax rate to 28%

1.1 Eligible Small business entities (turnover under \$2m)

Under this reform, the company tax rate for small business will reduce to 28% from 1 July 2012.

Financial year	Company tax rate
2011/2012	30%
2012/2013	28%

1.2 All other companies

A phased reduction in the company tax rate over two financial years until it reaches 28%. The reduction will commence from 1 July 2013 when the company tax rate reduces to 29% and then to 28% from 1 July 2014.

The reduction in the company tax rate is inextricably linked to the introduction of the Resource Super Profits Tax (see item 4.1 below). The reductions are timed to coincide with the implementation of this new tax.

Financial year	Company tax rate
2012/2013	30%
2013/2014	29%
2014/2015	28%

In its recommendation, the Government states that Australia's company tax rate is currently higher than comparably sized OECD countries. For Australian shareholders, company income tax is effectively a withholding tax on the Australian company profits. Foreign shareholders are effectively taxed at the company tax rate. That is, company income tax is a final tax for foreigners.

2. Instant asset write off for small business

An expansion of capital allowance concessions for small business will enable small business entities (turnover under \$2m) to:

- immediately write off assets valued under \$5,000 (up from \$1,000); and
- write-off all other assets (except buildings) in a single depreciation pool at a rate of 30%. Currently, there are two different depreciation pools (in effect, the long life pool will be removed).

Using the example from the announcements, come July 2012, a small business cafe that purchases a display fridge for \$4,000 will be able to claim a \$4,000 deduction in the first year. Under current rules, the cafe would be entitled to a \$600 deduction in the first year.

Estimated commencement date	1 July 2012
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3. Superannuation

3.1 Superannuation guarantee rate to increase to 12%

A phased increase to the superannuation guarantee until it reaches 12% by 2020.

Gradual increases to the superannuation guarantee will commence from 1 July 2013. Gradual increments of 0.25% will be introduced for the 2013/2014 and 2014/2015 financial years, and increases of 0.5% for each additional financial year until the superannuation guarantee reaches 12% in 2019/2020.

Financial year	Superannuation guarantee
2013/2014	9.25%
2014/2015	9.50%
2015/2016	10.00%
2016/2017	10.50%
2017/2018	11.00%
2018/2019	11.50%
2019/2020	12.00%

The interesting issue for many employers will be the impact of the increased superannuation guarantee on salary packages. In its report the Government has noted that the phased timeline will allow "...employers to take the increased SG contributions into account when negotiating future wage settlements."

Estimated commencement date	1 July 2013
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3.2 Higher 'catch up' concessional contributions caps

Permanent 'catch up' concessional contributions caps will be available to those aged 50 or over with super balances of less than \$500,000.

This permanently extends the transitional contributions cap which was due to expire from 1 July 2012.

Estimated commencement date	1 July 2012
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3.3 Superannuation guarantee limit increased to 75

An increase in the age limit for the superannuation guarantee to 75 (from 70) on 1 July 2013. Under this measure, workers aged 70 to 74 will be eligible to have SG contributions made on their behalf.

Estimated commencement date	1 July 2013
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3.4 Superannuation low income earners Government co-contribution

Low income earners with taxable incomes up to \$37,000 will be able to access a superannuation contribution of up to \$500 annually (not indexed).

The amount payable will be calculated by applying a 15% matching rate to the concessional contributions made by or for eligible individuals. The amount is paid into the individual's superannuation account.

The measure will provide a 15% tax concession on the superannuation guarantee contributions to individuals who have a 15% personal marginal tax rate. It will also remove the 15% tax penalty that individuals with a 0% personal marginal tax rate currently face in relation to their superannuation guarantee contributions.

Estimated commencement date	Contributions made from 1 July 2012 (contribution paid in 2013/2014)
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4. Resource sector

The resources sector is the hardest hit in the first wave of announced tax reforms. While there is some payoff to encourage continued resource exploration initiatives, over \$9 billion in profits is likely to be sucked out of the sector by 2013/2014.

4.1 Resource super profits tax

A 40% profits tax (resource super profits tax or RSPT) will be introduced on 1 July 2012.

The RSPT will be payable at 40% on the realised value of resource deposits, measured as the difference between the revenues generated from resource extraction and associated costs. The RSPT is a deductible expense for income tax purposes.

The RSPT will replace the crude oil excise, and operate in parallel with State and Territory royalty regimes. 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. The election into the RSPT will be irrevocable.

- Under the RSPT 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.

Transitional measures will provide a tax credit for previous investment made or committed to prior to the introduction of the RSPT (the book value of existing projects at the time of announcement). Previous investment will also be depreciated at accelerated rates. And, capital investments undertaken between the announcements and commencement of the new tax will be treated the same as post-commencement investment.

The rationale for the RSPT points squarely at ‘foreign ownership’ and the perceived need for Australia to get its ‘fair share’ from non-renewable resources. The Government is concerned that the tax take from resources has declined as a percentage of profits. For example, resource profits were \$80 billion higher in 2008/2009 than in 1999/2000. The equivalent tax take increased by \$9 billion. As a result, the Government wants its share.

Details of the RSPT and the timeline for consultation and implementation are contained in [The Resource Super Profits Tax -a fair return to the nation.](#)

Estimated commencement date	1 July 2012
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4.2 Resource exploration rebate

A refundable tax offset for exploration expenditure carried out in Australia. Available for exploration expenditure carried out on or after 1 July 2011, the tax offset is set at the prevailing company tax rate.

For administration ease, all companies will be able to access the rebate to avoid defining the concept of an ‘Australian small listed exploration company’ in tax law. The rebate will also be available to geothermal energy exploration.

Estimated commencement date	Expenditure incurred on or after 1 July 2011
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4.3 Infrastructure fund divvies up mining profits tax

The Government will create an infrastructure fund allocating \$700 million in 2012/2013 to be distributed to the States. In the announcement the Government states that it will provide a greater percentage of the fund to the resource rich states. In effect, the resource rich states will get a greater percentage of the Resource Super Profits Tax (see above).

WHAT HENRY REVIEW RECOMMENDATIONS WERE REJECTED?

The Government rejected a series of recommendations made by the Henry Review (and potential misinterpretations of the review). These include:

- Include the family home in means tests (see Rec 88c)
- Introduce land tax on the family home – this is a state tax and thus an issue for the states (see Rec 52 & 53)
- Require parents to work when their youngest child turns 4 (see Rec 85)
- Hit single income families (see Rec 92 & 93)
- Restrict eligibility to rent assistance for families (see Rec 103)
- Do 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 (see Rec 9e, 13, 41, 43 & 44)
- Reduce overall remuneration to the members of our defence forces (see Rec 6d, 8c & 9e)
- Reduce the CGT discount, apply a discount to negative gearing deductions, or change grandfathering arrangements for CGT (see Rec 14 & 17c)
- Remove the Medicare levy (see part of Rec 5)
- Reduce indexation of the age pension (see Rec 84)
- Remove the benefits of dividend imputation (see Rec 37)
- Think of hitting pensioner and low income concessions for utilities, transport and other essential services (see Rec 107)
- Introduce a bequests tax (see Rec 25)
- Align preservation age with pension age (see Recommendation in AFTS Retirement income strategic issues paper)
- Offer a government annuity product (see Rec 22)
- Ask the States to charge market rents to public housing recipients (see Rec 106)
- Abolish the Luxury car tax (see Rec 80)
- Index fuel tax to CPI (see Rec 65)
- Change alcohol tax in the middle of a wine glut and where there is an industry restructure underway (see Rec 71)

WHAT'S YET TO COME?

The Henry Review lists 137 recommendations of various strengths to the tax system. The Government's response to date has only touched on a small proportion of these. Some changes not ruled out as yet include:

- Tightening of personal service income rules so any owner/manager earning a significant portion of their income from their own personal efforts would be denied a series of business deductions (recommendation 10)
- Tightening up deductions so they have to be directly related to income production (recommendation 11)
- Removing and tightening a series of CGT small business concessions (recommendation 17)
- Removal of the tax on superannuation in the fund and instead tax employer contributions at marginal tax rates (recommendation 18)
- Halving tax on superannuation fund earnings to 7.5% (recommendation 19)
- Super guarantee to be paid at the same time as wages (recommendation 23)
- Immediate write offs for assets valued at less than \$1000 for non-small business entities (recommendation 28)
- Increase to the small business entity turnover test to \$5m (it's currently \$2m) (recommendation 30)
- Give companies the ability to carry back a revenue loss to offset it against the prior year's taxable income (recommendation 31)
- A flow through entity regime for closely held companies and fixed trusts – this would mean that from a tax perspective, there would be no difference between a company, trust or partnership structure (recommendation 38)
- Remove the broad exemptions for foreign employment income (recommendation 8b)
- Limiting access to the child care rebate for parents who do not work (recommendation 99c)
- Removal of the FBT exemption for employer sponsored child care facilities (recommendation 101)
- Removal of the medical expenses tax offset (recommendation 7a)
- Simplification of car fringe benefits to a rate of 20 cents per km (recommendation 9b)
- Fringe benefits readily attributed to the employee to be taxed through the PAYG system not FBT (recommendation 9)

It will be interesting to see what happens. Perhaps the upcoming Federal Budget will give us a better idea of the Government's commitment and pre election appetite to structural reform.

KEY LINKS

Australia's future tax system

- [Australia's future tax system website](#)

Cutting the company tax rate

- [Company tax rate reduction fact sheet \(non small business\)](#)
- [Company tax rate reduction fact sheet \(small business\)](#)

Small business depreciation

- [Small business depreciation fact sheet](#)

Superannuation

- [Extension to concessional contribution caps](#)
- [Increase to the Superannuation Guarantee charge](#)
- [Increase to the Superannuation Guarantee age limit](#)
- [Low income earner Government superannuation contribution](#)

Resources sector

- [Resource Super Profits Tax fact sheet](#)
- [Resource Super Profits Tax analysis and details](#)
- [Resource exploration rebate](#)

Infrastructure fund

- [Infrastructure fund fact sheet](#)

Announcements

- [Joint media release - Prime Minister & Treasurer](#)
- [Joint media release – Treasurer & Minister for Superannuation](#)
- [Media release – Minister for Resources & Energy](#)

The Henry Review and recommendations

- [Australia's future tax system](#)