

Australia's Future Tax System Review – How it will affect you

2 May 2010

The Report on Australia's Future Tax System ("Report") was released today, 2 May, 2010. With the Report has come the Federal Government's response, which is mainly an adoption of a new resources taxation regime and a limited deferred introduction of company and superannuation changes. Comprehensive acceptance of reform was missing.



The Report contains 138 recommendations about how Australia could better tax employment, savings, investment and consumption, and more efficiently distribute the revenue to enhance our social and economic wellbeing into the future.

The Report takes a holistic and long term view of reform. Many of the recommendations are directional or to the effect that further consultation must be had. However, the Henry Review Panel has thoroughly addressed key issues that affect the Australian taxation system, including our reliance on the production generated from use of our natural resources.

There will be widespread disappointment that the Government's response was not stronger or more directly supportive of the Report, especially given the time taken to consider the Report (more than four months) and the substantial investment taxpayers have made in this process so far.

The Government has underpinned its acceptance of reform on the introduction of a new Resources Super Profits Tax

(RSPT), so that the whole of the nation may benefit more from extracted resources. The resources sector will no doubt refute the country's capacity to continue to ride on the fortunes of the industry when investment into South America and Asia may become comparatively more attractive. The Government has indicated the RSPT is at the centre of its tax reform agenda, and indeed has stated that the delivery of all elements of the reform package will be contingent on the implementation of the RSPT.

The Report impacts all taxpayers. Significantly, there are detailed recommendations that reduce the tax burden on individuals and simplify compliance. Superannuation saving will be further supported.

The debate around change will continue. Tax reform arising from the Report will be a very significant part of our social agenda, and of business and investment planning, for years to come. The many positive recommendations in the Report deserve support, and Grant Thornton will advocate for active

adoption of measures that are sensible and beneficial.

What follows is our considered commentary and analysis of the Report, and the impact it will have on classes of taxpayers and, importantly, our clients. Please take some time to consider how the reform measures can benefit you.

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Resources

The RSPT will commence on 1 July 2012 and will impose a new tax at a rate of 40% on profits made from the exploitation of Australia's non-renewable resources.

Snapshot

A new 40% tax from 1 July 2012 on 'super profits' from exploitation of Australia's non-renewable resources applies to all legal entities (companies, partnerships and trusts)

- A refundable credit allowed for royalties paid to State and Territory Governments
- RSPT Taxable Profit determined as Assessable Receipts less Deductible Expenditure
- Need to maintain RSPT Capital Account recording undepreciated assets and unutilised prior year losses
- RSPT Deduction available for 'deemed interest' on RSPT Capital Account
- Transitional rules apply to pre 1 July 2012 projects
- Taxing point for RSPT yet to be clarified
- RSPT liabilities deductible and RSPT refunds assessable for income tax purposes
- Extensive industry consultation anticipated before finalisation of regime.

Business Impacts

Notwithstanding the obvious financial cost of an additional tax imposed on mining and petroleum companies, other impacts for business include:

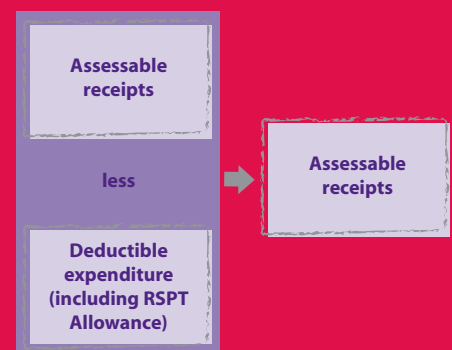
- State and Territory royalty payments after 1 July 2012 are refundable. Business will need to plan their transition to RSPT to minimise the risk of 'double taxation' (i.e. subject to non-refundable royalty pre 1 July 2012 and RSPT post 1 July 2012 on the same resource)
- Where audited accounts are not available, businesses need to determine the market value of projects existing at 2 May 2010 to determine RSPT Starting Base – such valuations might be complex and costly
- RSPT Starting Base, and ongoing RSPT analysis, needs to be determined on a project by project basis – historical records for existing projects may not be prepared to this detail
- Additional level of complexity in relation to financial reporting disclosure of tax balances – already for income tax and now also for RSPT
- Payments of RSPT will be deductible and are unlikely to generate franking credits for mining and petroleum companies. Whilst the overall tax cost will increase with the introduction of the RSPT, the available franking credits will likely decrease

Analysis

The RSPT will be charged at a rate of 40% of RSPT taxable income and will be calculated separately for each resource project interest.

RSPT Taxable income

RSPT taxable Income will be calculated as follows:



The RSPT will assess receipts from the sale of resources. However, the taxing point at which revenues are determined has not yet been finalised. The Government suggests the taxing point be set at the time a "saleable commodity exists" (e.g. the earliest time at which a world-price or arms-length sale could occur). Such an approach would be consistent with the current timing of recognition under the existing Petroleum Rent Resource Tax (PRRT).

Determination of the taxing point will form a key part of the industry consultation process as the RSPT legislation is developed.

The RSPT will allow deductions

for the cost of extracting resources and getting them to the taxing point, but will not allow a deduction for:

- interest and financing costs (including the cost of issuing shares, payment of dividends and financial hedging costs)
- payments to acquire interests in projects subject to the RSPT
- payments to acquire interests in existing permits and licences
- payments of income tax or GST

Unlike the PRRT regime, most capital expenditure will be written off over time, and the Government indicates its preference for the capital allowances regime to be adopted for the purposes of determining deductible amounts for the RSPT, with some allowance for streamlining for RSPT purposes.

RSPT Capital Account and Allowance

A deduction is available for the amortisation of the “RSPT Capital Account” for each year. In addition, a deduction will be allowed for an “RSPT Allowance” which reflects a deemed interest charge (calculated with reference to the 10 year government bond rate). The closing balance of the “RSPT Capital Account” from the previous tax year is used to calculate the RSPT allowance.

The closing RSPT capital account in a year is equal to the undepreciated value of tangible capital expenditure, plus any unutilised RSPT losses made in previous years.

The RSPT capital account is refundable at 40% on exit from the resources sector.

RSPT Losses

RSPT Losses will be carried forward (and uplifted by the RSPT allowance) and can

be claimed as a deduction against future RSPT Assessable Receipts within the entity or wholly owned company group.

Worked Example – The Resource Super Profits Tax

The table below shows the RSPT calculation for a project interest.

The project commences at the start of year 1, when \$100 is spent on capital. The Government recognises capital expenditure through depreciation arrangements – allowing in this example \$60 to be claimed as depreciation in year 1 and \$40 to be claimed as depreciation in year 2.

In year 1, the project does not have any receipts. As such, the project makes an RSPT loss of \$60 in year 1. The unutilised loss, \$60, will be carried forward with undepreciated assets, \$40, to make the RSPT capital base \$100 in total.

In year 2, the project has \$150 of receipts. The project is able to utilise the depreciation deduction in year 2 (\$40) and losses carried forward from the previous year (\$60) as well as the RSPT allowance (\$6).

The investor will have assessable profits of \$44 in period 2 and pay the government \$18 in RSPT.

Transitional Arrangements

The Government has announced its intention for existing resource projects to be subject to the RSPT, with the exception of projects already subject to PRRT. Subject to industry consultation, an irrevocable election will be allowed to transfer projects from the PRRT regime to the RSPT.

Under transitional arrangements, an entity will calculate its “RSPT starting base” which can be written off over five years. The RSPT starting base is not transferable or refundable.

The RSPT starting base is the sum of:

1. the accounting book value of existing project assets as at the most recent audited accounts available at 2 May 2010; and
2. the historical cost of all acquisitions of capital and exploration expenditure post 1. above and before 2 May 2010

The RSPT starting base is subject to indexation in accordance with the RSPT allowance rate.

Investment from 2 May 2010 to 30 June 2012 will be included in the RSPT capital account and treated the same as it would be under the new RSPT system.

Description	Item	Year 1	Year 2
Revenue	1	0	150
Less Expenses (such as depreciation)	2	60	40
Less RSPT Allowance (6% applied to RSPT capital base)	3	0	6
Less Unutilised losses carried forward from prior year	4	0	60
Net RSPT Profit (item 1 less items 2, 3, 4)	5	-60	44
Taxable RSPT Profit (nil if item 5 is negative)	6	0	44
Tax @ 40%	7	0	18
Initial investment (1 July in year 1)	8	100	n/a
Carry forward losses (item 5 if negative)	9	60	0
Undepreciated assets	10	40	0
RSPT capital base (items 9 + 10)	11	100	0



State & Territory Royalties

To ensure the RSPT is not a “double tax”, a refundable credit will be allowed in respect of state and territory royalties paid following commencement of the RSPT.

The amount of any refundable credit is capped at the amount of royalties currently imposed by State and Territory Governments as at 2 May 2010.

Consultation Process

The Government has acknowledged the need for extensive industry consultation in the formulation of the RSPT regime, including:

- determination of the taxing point for the RSPT
- mechanisms for minimising the compliance burden for smaller entities within the industry
- transition of projects currently subject to PRRT into the RSPT system

Preliminary consultation will be undertaken in May-June 2010, with more extensive consultation and Design Papers to be released in late 2010. The Government expects to release Exposure Draft Legislation in Mid 2011.

Resource Exploration Rebate

In formulating the scope of the review, the Government requested there be consideration of adopting a ‘flow-through share scheme’ which would pass on to shareholders the benefit of exploration deductions in exploration companies.

The Report instead recommended 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.

The recommendation has largely been adopted by the Government without, however, the restriction that the company be an Australian small listed exploration company.

Snapshot

- A refundable tax offset is available for exploration expenditure at the prevailing company tax rate (Note:

measures have been announced for reducing the company tax rate)

- Refundable tax offset available for companies only
- Applies for exploration expenditure incurred on or after 1 July 2011
- Definition of exploration expenditure will be expanded to include exploration for geothermal energy

Analysis

Under the current income tax rules, exploration expenditure and expenditure on depreciating assets first used in exploration is immediately deductible. However, for companies in the exploration phase and so with little or no taxable income these exploration deductions might be of little benefit, merely adding to tax losses to carry forward and offset against future income (if any ever arises).

Furthermore, entities undertaking geothermal exploration, a renewable energy source, currently do not have access to the immediate deduction for exploration expenditure. The definition of exploration expenditure will be expanded to include expenditure incurred in exploring for geothermal energy.

The new measure will ensure that the existing tax bias against smaller explorers, arising from their inability to readily utilise tax deductions, will be removed.

For a company in a tax loss position that spends \$1 million on exploration, the Resources Exploration Rebate will, at the current 30% tax rate, provide a cash benefit of \$300,000 – whereas previously that same company increased its tax losses by \$1 million.

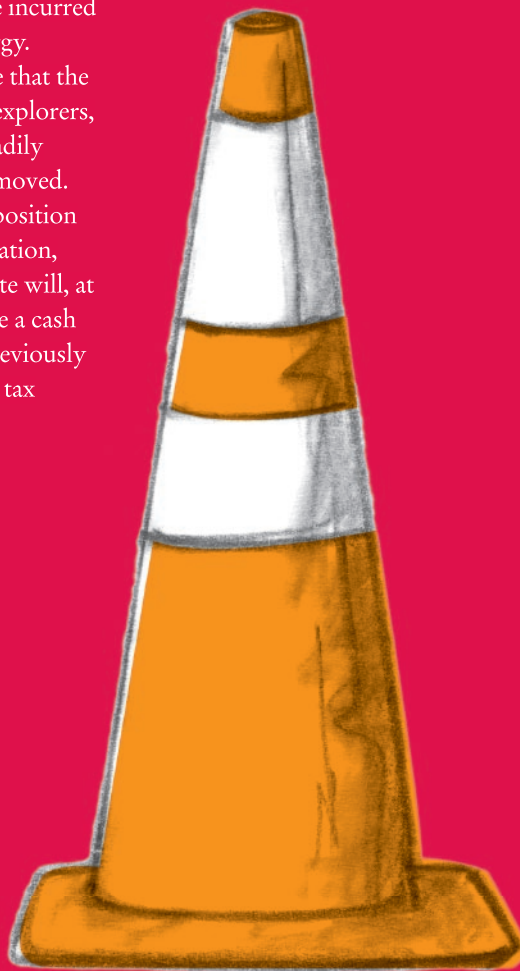
Consequential amendments will be made to the dividend imputation system to ensure companies are not liable to franking deficit tax as a result of a refund under the Resource Exploration Rebate, and will also ensure the franking credits available for the payment of a franked dividend will be the same as under the current system.

Business Impact

Given the rebate applies from 1 July 2011, companies with limited exploration funds or limited means to raise additional capital might wish to defer some exploration activities to 1 July 2011 or after (subject to other commercial considerations).

Any impacts should be considered in conjunction with the Resource Super Profits Tax.

The Government will consult on the exposure draft legislation to give effect to the rebate.



Superannuation and retirement

The four adopted reforms are:

- Increase the Superannuation Guarantee Contribution (SGC) rate to 12%: this will occur via 0.25% increases in 2013-14 and 2014-15, and then 0.5% increases for each of the following five years until 2019-20
 - employers will suffer additional employment costs of between 2.75% and 3% depending on their pay-roll tax rate
- A Government contribution for low income earners. The Government will make a contribution of up to \$500 per annum, for those taxpayers earning less than \$37,000 p.a. to ensure that no contribution tax is paid on SGC
- Higher concessional contribution cap of \$50,000 p.a. retained (from 1 July 2012) for those over 50, but only for those with less than \$500,000 superannuation. The current transitional cap of \$50,000 was to end on 30 June 2012, reducing to \$25,000
 - only 275,000 people will be impacted by this reform
- Raise the Superannuation Guarantee age limit to 75. Currently, SGC is not required to be paid for those over 70 years of age
 - only 33,000 individuals will be affected
 - employers will suffer increased employment cost of at least 12% for workers between 70 and 75



Impact

Treasury figures indicate that the above reforms will add \$108,000 to a 30 year old's savings at retirement

Recommendations not yet acted upon

The Report included some significant recommendations which have not been as yet acted upon.

The Report recommends:

- taxing the individual on contributions rather than the fund. Rather than the current 15% tax, marginal tax rates would apply, less a flat-rate refundable tax offset
 - the offset of 15% would apply for contributions up to an annual cap of \$25,000 (\$50,000 for those over 50 years of age) – i.e. same as current caps
- the rebate should replace the Government Co-Contribution and the Spouse Contribution Offset
- compulsory superannuation contributions should not be used in determining eligibility for income support or family assistance, and should not be used in the calculation of child support
- the rate of tax paid on earnings by super funds should be reduced from 15% to 7.5%. This would apply to capital gains, with no discount available. Imputation credits would still be available
- restrictions preventing those aged 75 or older from contributing should be removed. The work test for those aged over 65 should remain.



- No age restrictions should apply to those wishing to purchase longevity insurance from a prudentially regulated entity
- government should support the development of a longevity insurance market within the private sector, by issuing long-term securities, making data available to assist to calculate longevity risks, and removing prescriptive rules from superannuation laws that restrict product innovation
 - increasing people's awareness of their retirement savings, so that they can better manage their superannuation, by:
 - ensuring superannuation guarantee contributions are paid at the same time as wages
 - requiring employers to report superannuation contributions to employees when they are made

- introducing a method of linking superannuation records (e.g. using tax file numbers) to make it easier for people to manage their superannuation
- creating a superannuation portal where people can interact with government agencies and find information on retirement savings. Over time, this recommendation should be extended to allow people to manage all their superannuation through one channel

While some of these reforms are welcome, the proposal to tax individuals on their contributions removes an incentive to save for retirement. It especially would affect those with inconsistent incomes.

What's been ruled out

The Government has stated that it will not implement some of the Report's recommendations at any stage. For superannuation and retirement income, the only recommendation completely ruled out is one suggesting that the Government should offer immediate annuity and deferred annuity products to the public.

In addition, the Government has re-stated its intention to retain tax-free status on super withdrawals after age 60.

State and indirect taxation

The Report has recommended the replacement of pay-roll tax with a tax that better captures the value-add of labour (e.g. a broad-based wages tax or preferably a cash flow tax). The Report also recommends the removal of stamp duty, with a suggestion that more reliance be placed on broad-based taxes such as consumption and land taxes.

In relation to land tax, the Report has recommended that it be levied using an increasing marginal rate scale applying to the per-square metre value of the land, calculated on a per landholding basis (and not a total landholding basis). Low-value land, which would include most agricultural land, would not be subject to land tax if its value per square metre was below the lowest rate threshold. However, no principal place of residence or primary production exemptions would apply. We note that the Government has specifically stated that it does not propose to introduce land tax on the family home.

The Report also suggests that the States could raise revenue from taking a share of personal income tax (e.g. a flat rate surcharge on total income tax payable to the Australian government or a tax rate(s) on top of the uniform tax base). Further, the Report foresees a reduced role for the States in administering taxes in the future, with the ATO or a successor organisation being responsible for collecting taxes.

According to the Report, State tax

reform would need to be implemented over time and co-ordinated through agreements between the Federal Government and the States.

Local government

The Report recommends that local governments continue to have substantial autonomy in determining the rate of tax to be applied to property within their municipality.

Over time, the Report recommends that State land tax and local government rates should be integrated, which would include joint billing by State and local government so that taxpayers would receive a single assessment which identifies the State and local tax components. The recommendations also state that the same valuation methodology should be applied in order to calculate local government rates and land tax.

Rationalising other taxes

The Report has also recommended the abolition of all specific taxes on insurance products, such as the fire services levy and replacement with one broad-based consumption tax.

GST

The Report recommends that the government consider making further use of GST-free business to business transactions or reverse charging (but only if cost savings outweigh additional complexity costs and revenue risks).

Alcohol taxation

The Report recommends the taxation of all alcoholic beverages on a volumetric basis, with a single rate of tax applying over time. It also recommends the introduction of a low alcohol threshold for all products.

A further review of the administration of alcohol tax has also been recommended.

Tobacco taxation

The Report has recommended the retention of the existing tobacco taxation regime, with substantial increases in the rates of tax and the indexation of tobacco excise to a broad measure of wages and not CPI.

The removal of the duty free allowance on tobacco for travellers has also been recommended.

Gambling taxation

The Report has recommended that gambling taxation be reviewed and has suggested the elimination of gambling tax concessions for certain gambling businesses (e.g. clubs).

Consideration of the regulation and taxation of gambling to minimise conflicts between policy-making and revenue generation has also been recommended.

Small business

The Government response to the Report includes a number of tax concessions for small business from 1 July 2012 including:

- Small businesses will get a two year head start in the company tax cut, with a 28% rate applying from 1 July 2012
- A new immediate write-off for assets worth up to \$5,000 (the Report recommended asset value of \$10,000) to make asset ownership more attractive
- A new pool depreciation rate of 30% for all other assets to reduce complexity and accelerate tax relief

The Report did indicate that the taxation of small businesses needed simplifying and recommended a number of other measures which the Government has not included in its response. These include:

- The small business turnover eligibility threshold to increase from \$2 million to \$5 million
- Immediate deduction for all existing assets costing less than \$1,000
- A review of special provisions relating to capital allowances including investments in agriculture

We note that there are many recommendations in the Report that may have implications for small businesses including potential changes to trust taxation, personal services rules, and realigning the small business CGT concessions to accommodate the general increase in the eligible small business turnover threshold noted above.



Corporate

Recommendations to be adopted Reduction in company tax rate

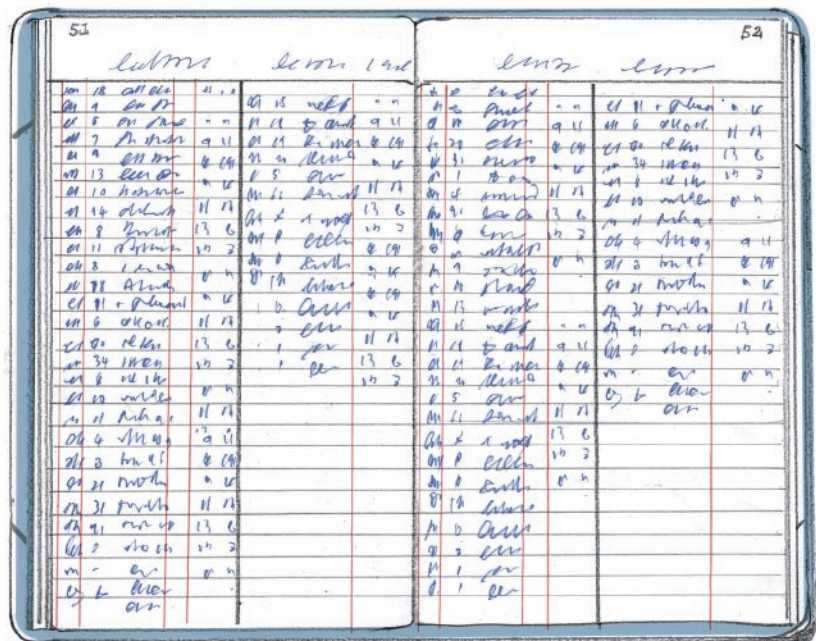
The Government has responded to the Report's recommendation of a drop in the company income tax rate to 25% in the medium term by announcing that the rate will drop to 29% in the 2013-14 income year and then to 28% in the 2014-15 income year. The current company tax rate is 30%.

The Report acknowledges that Australia's corporate tax rate was high, when compared to other OECD nations. By reducing the company tax rate, the Government expects Australia to continue to be an attractive place to invest and a reduction in the desire by large multinationals to shift profits out of Australia. A lower company tax rate should also encourage innovation and entrepreneurial activity.

The Report recommended that no structural changes to Australia's corporate tax system (i.e. the basis by which companies and shareholders are taxed) be made in the short to medium term.

Recommendations not yet acted upon Loss carry back

The report recommends that companies should be able to offset losses made in a particular income year against taxable income from the preceding year. This effectively provides companies with a tax refund to the extent of company tax paid in the previous year. Any refund would be limited to the company's franking account balance. The



Government has not specifically adopted this recommendation, nor rejected it. Therefore, it may be considered as part of future debates on Australia's tax system.

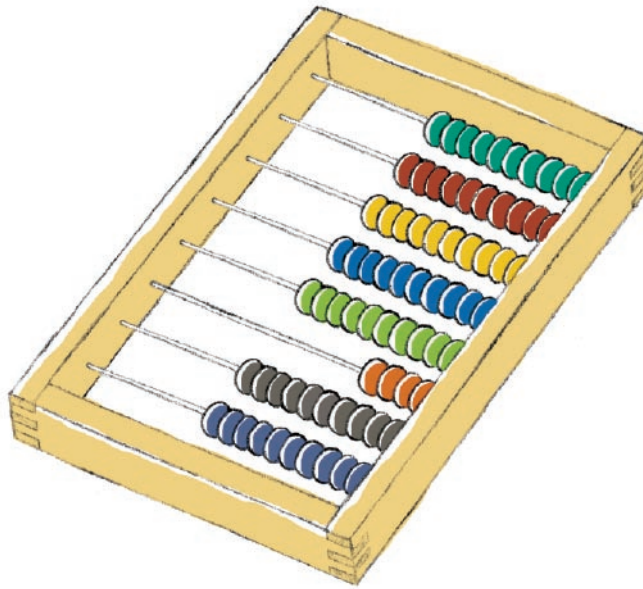
From a policy perspective, this change would improve the ability of the tax system to serve as an automatic stabilizer during economic downturns. It is hoped that had such a measure been introduced in the previous Federal Budget it would have helped to mitigate the affect on Australian companies of the global financial crisis.

Such a measure also encourages risk-taking and innovation by companies that have been profitable in the past, as any future losses generated would provide them with a tax refund.

Interest withholding tax

A recommendation has been made for interest withholding tax to be removed on interest paid to non-residents by financial institutions operating in Australia. Under current laws, financial institutions operating in Australia may be required to withhold 10% of any interest payments made to foreign residents in certain circumstances. The current rules are believed to distort Australian financial institutions' access to the global debt market.

A further recommendation was made in relation to interest withholding tax, whereby Australia should seek to eliminate it with countries that it has



entered into Double Tax Agreements with. Changes to Double Tax Agreements would need to have the necessary safeguards (e.g. information sharing) to remove the risk of tax avoidance.

Managed funds industry

The Report recommends that conduit income of Australian managed funds should not be subject to Australian tax. The report acknowledges this area of reform contains complex and technical issues, and as such requires separate consideration.

The basis for this recommendation is the difficulty around determining the residency of investors and whether the income derived by the managed fund has an Australian source. Generally, foreign residents are not taxable in Australia on foreign sourced income. Given the ease with which capital can flow today between fund managers located around the world, this recommendation is seen as increasing the competitiveness and attractiveness of the Australian funds management industry.

Dividend imputation system

In the lead up to the release of the Report, there was considerable speculation in the media as to how Australia's dividend imputation system would be impacted. In short, it was recommended that the current dividend imputation system be retained. The Government has come out immediately in its response to the Report stating that it has no intention of

removing dividend imputation.

Under the dividend imputation system, shareholders in receipt of dividends are provided with a credit for the tax already paid by the company on the profits out of which the dividend was paid. Individual shareholders and superannuation funds are entitled to a refund on excess imputation credits. As such, there are many shareholders relieved to hear that there will be no change to Australia's dividend imputation system.

The Report recommends that dividend imputation should be retained in the short to medium term, but for the longer term, consideration should be given to alternatives as part of a further consideration of company income tax arrangements. This takes into account global trends – the only two OECD nations with dividend imputation systems are Australia and New Zealand.

The Report also stated that whilst dividend imputation is retained, imputation credits should continue to be provided only for Australian company income tax. Submissions to the Report requested that Australian companies should be allowed franking credits for foreign taxes paid and that dividend streaming (e.g. paying franked dividends only to resident shareholders and non-franked dividends to non-resident shareholders) should be permitted. The Report was steadfast in its opinion that the current prohibitions and integrity rules around imputation be retained.

Flow-through entity regime

The Review Panel was asked to consider whether a flow-through entity regime for closely held companies and fixed trusts was appropriate. The ultimate recommendation was that a flow-through entity regime should not be adopted for now, but would merit further consideration if there is a move away from dividend imputation in the long run.

Under the flow-through entity regime, income and losses of the company or trust would be assigned to shareholders and beneficiaries regardless of whether they were distributed. Although the Report acknowledged the benefits of such a regime, its main concern was introducing greater complexity into the Australian taxation system.

Harmonisation with New Zealand

Given increasing trans-Tasman financial dealings, if increased integration of the Australian and New Zealand economies is desired, a broad examination of the appropriate degree of harmonisation of business income tax arrangements (e.g. capital gains tax, the treatment of foreign source income, the taxation of financial arrangements) between Australia and New Zealand should be undertaken.

Individuals



Recommendations not yet acted upon

The Report included some significant recommendations to reform the taxation of individuals – none of which have been as yet acted upon.

The Report recommendations can be summarised as follows:

- A higher tax-free threshold of \$25,000 with a constant marginal rate of 35% for 97% of tax payers
- A 40% “savings income” discount to be provided to individuals for non-business related:
 - net interest income
 - net residential rental income
 - capital gains (and losses)
 - interest expense related to listed shares held by individuals as non-business investments
- No tax on bequests (which seems to rule out any form of estate tax)
- The current rules imposing taxation on trust income and gains should be updated and rewritten to reduce complexity and uncertainty
- Individuals to continue to be assessed separately, with the potential exception of couples of late retirement age, and restricting subsidies for dependents
- Overhaul of the current regime of tax offsets, by consolidating the available offsets and removing some altogether by incorporating them into the new personal income tax scale which includes the introduction of the \$25,000 tax free threshold
- There should be a tighter nexus between the deductibility of work-

- related expenses and their role in producing income
- Income support and supplementary payments (e.g. family assistance and scholarships) should be tax-exempt
- Reform the personal services income regime, with a focus on closely-held entities where a significant portion of the income is derived from the personal services of their owner-managers. Arm’s length rules would apply to all related party payments
- Availability of a standard deduction to cover work-related expenses
- An increase in the deductibility threshold for gifts and donations from \$2 to \$25 per recipient entity per year (but the Government has rejected this)
- The medical expenses tax offset should be abolished. The Medicare

- levy surcharge and assistance for private health insurance should be reviewed
- Assistance for private health insurance should be provided exclusively as a direct premium reduction

What’s been ruled out

The Government has stated that it will not implement some of these recommendations at any stage. The Government will not:

- abolish the Medicare Levy
- reduce the capital gains tax discount in line with the proposed savings income discount
- apply the savings income discount to negative gearing deductions
- remove the luxury car tax
- increase the tax-deductible donations threshold beyond the current \$2

Capital Gains Tax

The Report included the following blue sky proposals in respect of the Capital Gains Tax (CGT) regime which the Government has not included within its response:

- Changes to small business CGT relief, including removal of the active asset discount and 15-year exemption, increasing the lifetime limit retirement exemption and more generous access to those who dispose of an interest in a trust or company
- An increase in the exemption threshold for collectables (currently \$500) and exempting other personal use assets
- Rewrite the CGT provisions and integrate more fully with other relevant provisions

It is noted the Report recommended removing the amnesty for assets purchased prior to the introduction of CGT on 20 September 1985 but the Government has ruled out implementing this recommendation.



Property and housing



Announced Changes

The Government's response to the Report did not have an immediate specific impact on the property sector.

However, the Report includes some bold recommendations affecting property, including the following:

- There is no role for any stamp duties, including conveyancing stamp duty, in the modern Australian taxation system
- Stamp duty should be replaced with land tax, with the scope of land tax broad enough to cover all land
- In order to tax more valuable land at higher rates, consider levying land tax using an increasing marginal rate schedule, with a zero rate on low-value land with the threshold determined by per square metre value
- Tax rates should be based on the value of the land without consideration of the use of the land. This is designed to prevent any disincentive for certain types of development
- An incremental approach to the reforms could be considered:
 - applying land tax to individual holdings of land rather than on a total holding basis as is currently the case in most States
 - removing stamp duty on commercial and industrial properties in return for a broad land tax on those properties
- local governments should be left to set the tax rate applicable to property within their municipality, however over time state land tax and local

government rates should be more integrated

- the valuation methods to calculate the base for local and state government tax, as this could reduce administration costs. Also, rates and taxes could be imposed in one single assessment that identifies local government rates and state government land tax in a transparent manner
- COAG should place priority on a review of institutional arrangements (including administration) to ensure zoning and planning do not unnecessarily inhibit housing supply and housing affordability
- the system of infrastructure charges should be reformed
- the current income and asset tests for income support payments (including presumably housing assistance) should be replaced with a comprehensive means test based on a combined measure of employment income, business income and deemed income on assets
- various reforms to rent assistance have been proposed, in particular, that the maximum rate of rent assistance be increased to assist renters to afford an adequate standard of dwelling and, to align with this approach, that income-linked rents should be phased out for social housing and market

rents should be charged instead

The broad intention of the recommendations is to scrap stamp duties and replace the revenue for states with increased income from land tax. Whilst this does get rid of an inequitable tax, the risk is that the replacement is no better. If all stamp duties are abolished, the one-off burden on landowners becomes an ongoing one. Depending on the rate charged, this may impact adversely. Aside from the obvious cash flow disadvantage, the altered arrangements may reduce property valuations which would impact banking covenants. Also, owners of vacant land may need to accelerate development to permit tax deductibility of the land tax.

This is balanced with positive changes such as the move to impose tax on individual holdings rather than by total which will remove the penalty on larger developers with larger scale projects.

What's been ruled out

The Government has explicitly stated that:

- the family home would not be subject to land tax reform
- the family home will not be means tested
- rent assistance will not be administered as part of the income support system.

Not for profit sector

The Government has promised not to touch taxation of the not-for-profit sector or clubs. So whilst the Report recommends a number of changes, it will be business as usual for these organisations.

The main recommendations of the Report (which will not be introduced) involve removing the FBT concessions

and replacing them with direct funding assistance, and simplifying tax arrangements for clubs that currently rely on the principle of mutuality to ensure income from members is not taxable.

Many organisations which rely on tax effective salary packaging arrangements to remunerate their staff adequately will be breathing a collective sigh of relief

with this news. However, whilst the FBT concessions may technically remain, if the recommendation to tax remuneration related benefits in the hands of individuals is ever taken up, this will have a major impact on the way in which remuneration packages are structured.

Fringe Benefits Tax

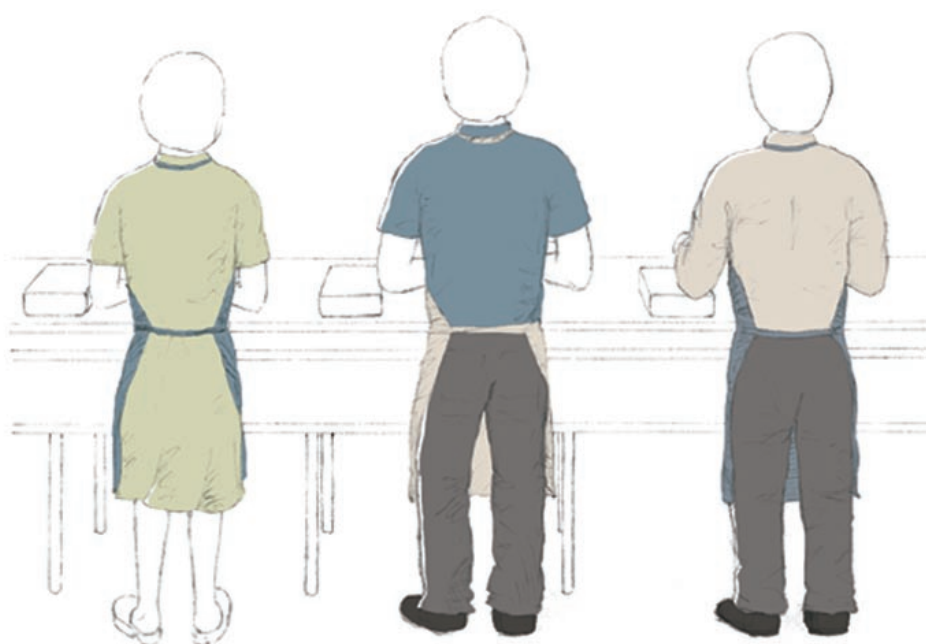
The Government has not ruled out changing the way in which fringe benefits are taxed in general. However, any such change would obviously be a long way off.

The Report recommends that remuneration related fringe benefits be taxed in the individual's hands under the PAYG system. Other benefits incidental to employment should continue to be

taxed at the employer level at the highest marginal rate, but not be reportable for employees. Further, the scope of the FBT system should be simplified by introducing an employer exemption threshold, reviewing other exemptions and moving to a flat rate of 20% for the statutory formula for car benefits.

Introducing these changes would obviously have a major impact on

employers and employees, since the fundamentals of how to value and report the benefits as well as the applicable level of tax and who pays it would all be affected. However, as the Government has been silent in its response to these items, it seems the appropriate action to take is simply to “watch this space” but without holding your breath!



Roads and environment

Road transport taxes

The Report proposes a major reform of road transport taxes, to ensure quicker, more reliable trips on roads that are less congested and better maintained. The Report has suggested that congestion charges apply to all registered vehicles using congested roads, as well as the development of pricing to ensure that heavy vehicles pay for their specific marginal road-wear costs. The Report also recommends that the Government continue to reform road infrastructure provision for investments to ensure future demand is satisfied. It has been proposed that a single institution lead the tax reform, with the establishment of a National Road Transport Agreement to guide the Government in the use and supply of road infrastructure.

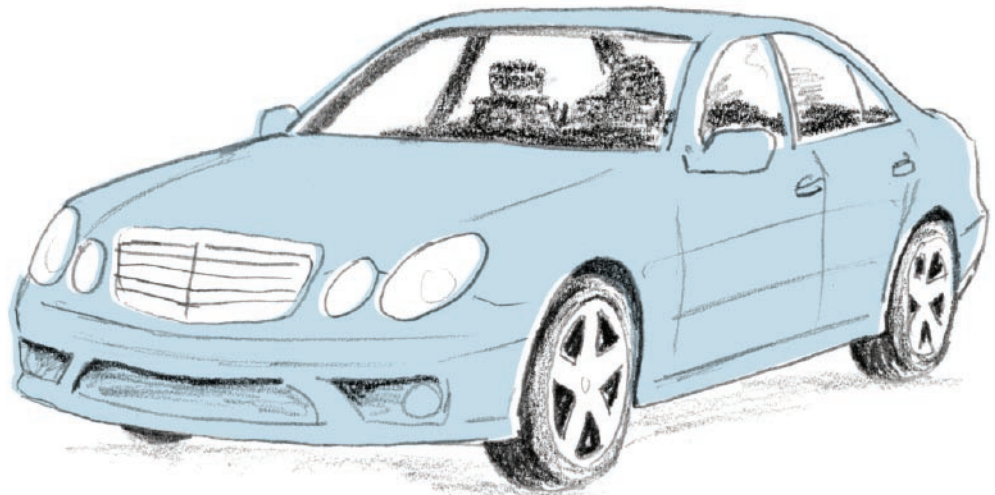
The Government has stated that it will not implement the recommendation to apply fuel tax to all fuels used in road transport indexed to the CPI.

Environment taxes

The Government has not responded to recommendations made on environmental taxes.

The Report recommends that, once introduced, the efficiency of the Carbon Pollution Reduction Scheme (CPRS) should be regularly monitored and improved where appropriate and that tax concessions be phased out and replaced with targeted spending programs in many instances. Furthermore, the Report recommends that other measures which seek to reduce emissions and are not justifiable on other grounds should be phased out once the CPRS is in operation.

As these recommendations appear to be uncontroversial, it is possible they will be considered by the Government once the CPRS has begun.



Compliance costs/administration

The Report makes several recommendations which are intended to reduce the compliance burden and improve efficiency for taxpayers and recipients of tax transfer entitlements.

These recommendations include:

- Pre-filled personal income tax returns
- Alignment of definitions and streamlining of mandatory reporting for tax returns and transfer entitlements
- A privacy and secrecy framework to be developed allowing the transfer of information between government agencies whilst protecting the individual's personal information
- Relevant third parties should be required to provide government agencies with the information required to calculate tax liabilities and eligibility for transfer entitlements
- Further reduction in compliance costs for businesses

The Government has not covered these recommendations in its initial response.

Transfers tied to Goods and Services

The Government provides some transfers that are tied to the purchase of certain goods and services. For example, discounts for concession holders, rebates on certain merit products and Government supported goods and services such as public hospitals and schools. The reason that some transfers are provided in this form instead of cash is to encourage certain consumption and limit undesirable consumption.

The Report has recommended that the Productivity Commission review concessions provided across all levels of government and look into the mechanisms that are available to the government to deliver public services. The findings of the Productivity Commission should then be considered by COAG.

The Government is yet to respond to these recommendations.

Administration

A Responsive and Accountable Tax System

Proposed changes will establish a more transparent approach to community ideas for tax changes by extending the use of the Tax Issues Entry System website.

Improved clarity of policy objectives of the tax laws will be achieved through the commitment to an open, principles-based approach to tax law design and administration. The recommended changes also aim to improve the accountability of the ATO through the establishment of an Advisory Board to the Commissioner of Taxation regarding matters of the general organisation and management of the ATO.

Monitoring and reporting on the system

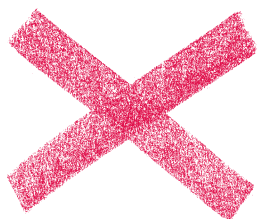
The Report suggests that monitoring the system is essential in evaluating its long term performance, through periodic analysis of unbiased and systematically collected data on the tax system.



Measures to report on the overall performance of the system have been recommended, such as the systematic collection of data on existing taxes and transfers and support for independent research on Australian tax and transfer system policy.

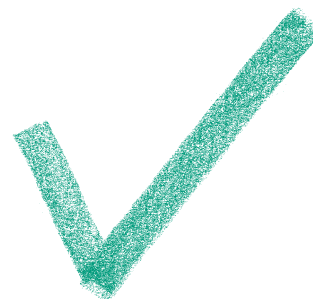
The Report also suggests means to achieve higher standards of transparency and accountability to all forms of Government expenditure. The report recommends that the Government should measure and treat tax expenditures and spending programs symmetrically in Budget decision-making processes as well as ensure a more effective, comprehensive and consistent method of reporting of tax expenditures through the development of reporting standards.

Summary of what's in and what's out



The Government has responded to the Report by declaring that it will not implement change to:

- Remove the benefits of dividend imputation
- Harm the not-for-profit sector by removing tax concessions, raising the gift deductibility threshold or changing income tax arrangements for clubs
- Include the family home in mean tests
- Impose land tax on the family home
- Reduce the 50% CGT discount or apply “a discount” to negative gearing deductions
- Remove the Medicare levy
- Introduce a tax on bequests
- Abolish the luxury car tax
- Index fuel tax to CPI
- Reduce age pension indexation
- Alcohol tax



The Government has announced the introduction of:

- Resources taxation reform
- Gradual reduced company tax rates to 28%
- Small business concession
- Superannuation measures

Contact your local tax service line leaders

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