Inland Revenue
Te Tari Taake

POLICY ADVICE DIVISION

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax policy report: Australia releases Henry Tax Review

Date:	3 May 2010	**Priority:**	High
Security Level:		**Report No:**	PAD2010/81 T2010/735

Action sought

	Action Sought	Deadline
Minister of Finance	**Note** the contents of this report	None
Minister of Revenue	**Note** the contents of this report	None

Contact for telephone discussion (if required)

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3 May 2010

Minister of Finance
Minister of Revenue

Australia releases Henry Tax Review

Executive summary

Australia has announced a package of tax and superannuation savings reform measures to coincide with the release of the Henry Tax Review. There is nothing of major concern to New Zealand in the proposals that Australia has put forward.

The current income tax system will be retained along with imputation. The reform package is designed to be fiscally neutral. The major policy announcements are that Australia will:

- **Reduce their company tax rate** from 30% to 29% in 2013/14 and to 28% in 2014/15. For SMEs (turnover of less than AUD $2 million p.a.), the company tax rate will be reduced to 28% from 2012/13.

- Reform the taxation and royalty arrangements for mining. Key initiatives are:

  - Introducing a **40% tax on the super profits of mining projects.** "Super profits" would be calculated as the excess profits of a project after deducting from the income of the project the amount that could be earned on all the assets of the mining project using a risk-free rate of return (e.g. the amount that could be earned if the assets were invested in government bonds).

  - Introducing a **rebate for resource exploration expenditure.** This will benefit mining companies in tax loss and in particular smaller mining companies that have not yet become profitable as it will allow them to cash out tax losses.

  - Establishing a **state infrastructure fund** funded from the super profits tax to provide States with funding for infrastructure investment. It will be used for both economic and social infrastructure projects and will cost $700m in 2013/14 and $735m in 2014/15.

- Introduce a **more generous depreciation regime for SMEs**. From July 2012 SMEs will be able to immediately write-off assets valued under $5000 (up from $1000 currently), and assets of more than $5000 (except buildings) will be put into a single pool and depreciated at 30% p.a.

- Increase **compulsory superannuation**. The main change is to increase the compulsory employer contribution rate from 9% to 12% of employees' income from 2013 to 2019. The government will also subsidise contributions for lower income workers.

The Henry Review report includes 138 recommendations. Aside from the above reform package, the Australian government has not endorsed any of these, explicitly rejected some of them (see appendix) and identified others as worth longer-term consideration. From New Zealand's perspective some of the more important Henry Review recommendations are that Australia should:

- **Retain its imputation regime in the short to medium term.** (The Australian government announced that it will be retaining imputation). On the issue of **mutual recognition** of Australian franking credits and New Zealand imputation credits the Henry Review noted that this would impose higher revenue costs on Australia than on New Zealand, but that this should not preclude mutual recognition if greater economic integration was considered desirable. It also noted that rather than considering mutual recognition in isolation, it could be more useful to consider it alongside other measures to harmonise company income tax settings.

- **Consider increasing taxes on consumption.** In scoping the Henry review, the Australian government ruled out changes to increase the rate or broaden the base of GST. However, the Review Panel did recommend that Australia consider introducing a broad-based cash-flow tax. This would have similar economic effects to a broad-based GST.

- **Consider introducing a land tax** that would apply to all types of land but which would be progressive based on value per square metre, starting from a zero rate for low-value land (this would effectively exclude agricultural land). The government response ruled out applying a land-tax to the family home and said that land taxes were a state issue, for states to consider.

We plan to provide a further report on the Henry review and other Australian tax reforms after the Australian budget.

Recommended action

This report is for **noting.**

Steve Cantwell
for Secretary to the Treasury

Matt Benge
Assistant Deputy Commissioner, Policy
Inland Revenue

Hon Bill English
Minister of Finance

Hon Peter Dunne
Minister of Revenue

Background

1. In May 2008 the Australian government commissioned a review of Australia's tax system by a panel chaired by Dr Ken Henry, Secretary to the Treasury ("The Henry Review"). The panel delivered their 1000 page, 138 recommendation report to the Government in December 2009.

2. Yesterday, Australia released the Henry Tax Review and announced a package of tax and superannuation savings reform measures. Information on these announcements and comparable New Zealand settings is outlined below.

3. We plan to provide a further report on the Henry Review and other Australian tax reforms after the Australian budget.

Australian Policy Announcements

Overall

4. The current income tax system will be retained along with imputation. The reform package is designed to be fiscally neutral; a new tax on "super profits" from the mining sector will generate revenues that will be used to reduce taxes on other companies (especially small businesses), increase superannuation savings and fund additional state infrastructure.

5. The reform package is consistent with the Henry Review recommendations. A general theme of the Henry Review was that Australia should look to increase taxes on immobile factors (such as resources and land) and on consumption in order to reduce taxes on companies and savings.

Company tax rate

6. Australia has announced that it will reduce its company tax rate from 30% to 29% in 2013/14 and to 28% in 2014/15. For SMEs (companies with turnover of less than AUD $2 million p.a.), the company tax rate will be reduced to 28% from 2012/13. The slow and gradual nature of these reductions is because the reform package is supposed to be revenue neutral overall and it will be several years before the new resource super profits tax generates significant revenue.

More generous depreciation regime for SMEs

7. As well as getting the 28% company tax rate two years sooner than larger companies, SMEs (businesses with turnover of less than AUD $2 million p.a.) will benefit from a more generous depreciation regime. From July 2012, SMEs will be able to immediately write-off assets valued under $5000 (up from $1000 currently), and assets of more than $5000 (except buildings) will be put into a single pool and depreciated at 30% p.a. (currently SME assets are depreciated in two seperate pools).

8. This is an extension to the simplified tax rules that Australia has for SMEs. New Zealand does not have a concessionary depreciation regime for SMEs. New Zealand's depreciation rules provide an immediate deduction for assets of $500 or less, and allow pooling of assets that are worth less than $2000.

Resource super profits tax

9. In order to pay for the other parts of the reform package, the federal government has announced that it will introduce a 40% tax on the super profits of mining projects. "Super profits" would be calculated as the excess profits of a project after deducting from the income of the project the amount that could be earned on all the assets of the mining project using a risk-free rate of return (e.g. the amount that could be earned if the assets were invested in government bonds).

10. States will continue to levy royalties on minerals but these royalties will be refunded by the federal government (by being credited towards the resource super profits tax). Mining companies will also get a deduction for the amount of resource super profits tax they have paid when working out their company tax liabilities. The tax will apply to both new and existing projects, but assets from existing projects will be given a generous depreciation treatment (fully depreciated over 5 years).

11. Compared to the existing system of state mining royalties, the resource super profits tax will generate additional revenue ($3b in 2012/13 and $9b in 2013/14) but reduce tax on marginal mines and mines in the set-up phase. The Australian Treasury expects this to increase overall mining production.

12. Mining companies in tax loss, and in particular smaller mining companies which are yet to generate taxable profits, will benefit from the introduction of a rebate for resource exploration expenditure. From July 2011, these companies will be able to cash out tax losses from exploration expenditure.

13. In New Zealand, the Government collects royalties on minerals and petroleum. The royalties are set through regulation. For low value to weight or volume minerals such as coal, royalties are levied per tonne sold, while gold, silver and platinum can be subject to royalties of 1% or 2% of net sales revenue or 5% accounting profits depending on when the permit was issued and the total sales value. Petroleum royalties are collected on the higher of 5% of net sales revenue or 20% of accounting profits. The Ministry of Economic Development is currently leading a review of the regulatory, tax and royalty regime faced by mining companies and is expected to report later this year.

State Infrastructure Fund

14. Australia has also announced that it will establish a state infrastructure fund. It will be used by the state governments for both economic and social infrastructure projects and will cost $700m in 2013/14 and $735m in 2014/15.

Compulsory Superannuation changes

15. The Australian government announced several changes that will increase superannuation contributions. The main change is to increase the compulsory employer contribution rate from 9% to 12% of employees' income from 2013 to 2019. It will go up quarter of a percent for the first two years (2013 and 2014) and then go up half a percent a year, for each year thereafter until 2019.

16. Other changes to the compulsory superannuation scheme include:

- Those earning below $37,000 will receive a $500 p.a. government contribution to their scheme. This is to address equity concerns with the current arrangements under which higher income earners can benefit from the flat tax of 15% on all contributions (low income earners cannot as they already pay tax at 15%, as opposed to a higher rate). The Henry Review had recommended that superannuation contributions should be initially taxed at each taxpayer's marginal rate (which can be up to 45%) before applying a flat rebate to all taxpayers.
- Requiring employers to make compulsory superannuation contributions until their employees are 75 (up from 70 currently).
- Reducing the limit on superannuation contributions - For those over 50, the current cap of AUD $50,000 p.a. will reduce to $25,000 p.a. if the person has more than $500,000 in superannuation funds. For those with less than $500,000, the contribution cap will remain at $50,000 p.a. to allow them to catch up. The new contribution limits are more generous than what was previously announced ($25,000 p.a. for everyone), but less generous than the $50,000 p.a. limit for over 50s recommended by the Henry Review.

Henry Review recommendations

17. The Henry Review report includes 138 recommendations. Aside from the above reform package, the Australian government has not endorsed any of these, but has explicitly rejected some of them (see appendix) and identified others as worth longer-term consideration. Some of the more important Henry Review recommendations are outlined below.

Imputation and mutual recognition

18. The Henry Review recommended that Australia retain an imputation regime in the short to medium term. The Australian government has since stated that it will be retaining imputation. On the issue of mutual recognition of Australian franking credits and New Zealand imputation credits the Henry Review noted that this would impose higher revenue costs on Australia than on New Zealand, but that this should not preclude mutual recognition if greater economic integration was considered desirable. It also noted that rather than considering mutual recognition in isolation, it could be more useful to consider it alongside other measures to harmonise company income tax settings.

19. *[information deleted to avoid prejudice to the entrusting of confidential information by a foreign government or international organisation, and in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*

Taxes on Consumption (GST)

20. In scoping the Henry review, the Australian government ruled out changes to increase the rate or broaden the base of GST. This limited what the Henry Review could recommend on consumption taxes. However, the Review Panel's recommendation for Australia to consider introducing a broad-based cash-flow tax was based on the fact that broad-based consumption taxes (such as GST) are an economically and administratively efficient way to raise revenue.

21. In its response to the review, the Australian government reaffirmed that it will never increase the rate or broaden the base of the GST or remove tax free superannuation payments for the over 60s (which was also ruled out by the Henry Review's terms of reference).

22. New Zealand's GST has a broader base than Australian GST (e.g. we do not exempt food), and is regarded as the most efficient GST system in the world.

Land Tax

23. The Henry review recommended that Australia consider introducing a land tax that would apply to all types of land but which would be progressive based on value per square metre, starting from a zero rate for low-value land (this would effectively exclude agricultural land). The government response ruled out applying a land-tax to the family home and said that land taxes were a state issue, for states to consider.

Charities

24. The Henry Review recommended some rationalisation of the tax concessions available to the not-profit sector, most notably raising the threshold for tax deductible donations from $2 to $25, however the Australian government has ruled out making any changes that would harm the not-for-profit sector.

Appendix – From Ministerial Statement: rejected Henry Review Recommendations

The Australian government's Ministerial statement included the following announcement.

"Today we have announced that the first wave of our agenda is to reform resource, company and small business taxes and superannuation. We are also attracted to developing changes in 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. This would represent a full second term agenda.

Other recommendations in the review are not government policy. We have called for a mature tax debate and expect the other recommendations to be subject of much debate in the coming years.

In the interests of business and community certainty, the Government advises that it will not implement the following policies at any stage. *[information deleted to: avoid prejudice to the entrusting of confidential information by a foreign government or international organisation; free and frank]*

- 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)

The Government also reaffirms that it will never increase the rate or broaden the base of the GST or remove tax free superannuation payments for the over 60s, which were both ruled out of the AFTS Terms of Reference."