CONTINUING TAX REFORM

STATEMENT BY
THE HONOURABLE PETER COSTELLO MP
TREASURER OF THE COMMONWEALTH OF AUSTRALIA
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CONTENTS

SUMMARY

This budget includes major tax reforms in superannuation, personal income tax and business tax and is supported by measures to improve the integrity of the tax system. It is a major step in structural tax reform that commenced with *The New Tax System* in July 2000.

The reforms undertaken by the Government over the past 10 years have ensured that Australia remains a low taxing country — the eighth lowest in the OECD. Tax reform has enhanced our prospects for higher employment and productivity growth, improved the equity and fairness of the tax system and reduced tax system complexity. The reforms have been undertaken while improving the sustainability of Australia's budget position and eliminating government debt.

The next stage of the Government's tax reform agenda, announced in this year's budget, builds on these principles and includes:

- a plan to simplify and streamline Australia's superannuation system, which represents the most significant change to the superannuation system in nearly 20 years;

- major tax relief for all taxpayers, with $36.7 billion in personal tax cuts over the next four years which have been designed to improve incentives to work and enhance the international competitiveness of our top tax rates;

- a continued commitment to families with an increase in the income test threshold for the maximum rate of Family Tax Benefit Part A (FTB (A)) to $40,000 a year and extending eligibility for the Large Family Supplement to families with three or more children;

- enhanced tax depreciation arrangements which will provide a benefit to business of $3.7 billion over four years and improve investment incentives and resource allocation, improving prospects for higher productivity and higher growth;

- additional reductions in taxes on small business worth $435 million, to simplify and improve the alignment of thresholds and eligibility for a range of small business tax arrangements, and improve access to the small business capital gains tax arrangements; and

- tax integrity measures estimated to raise $2.3 billion in revenue, to help ensure an equitable tax base is maintained.

INTRODUCTION

In July 2000, the Government introduced the largest tax reform in Australian history, introducing *The New Tax System*. It was designed to make our economy stronger, generate more jobs, improve living standards and fund essential services. The inefficient wholesale sales tax and a raft of inefficient state taxes were replaced with the goods and services tax (GST). The Australian Government has now reached agreement with all the States on a timetable to complete this process.

The New Tax System introduced significant personal income tax reductions and reforms to the family tax benefit system. Since *The New Tax System* the Government has continued its tax reform agenda. Reforms have been introduced to increase incentives to work, save and invest, improve Australia's international competitiveness and reduce complexity and the compliance burden the tax system places on Australians. These changes are summarised in Box 1 with more detail provided in Appendix A.

Tax reform is an ongoing process. Tax reform is not a once-for-all-time event, nor does it involve concentrating on just one particular element of the tax system. Tax reform requires the full consideration of the taxation system as a whole, the careful balancing of competing priorities and awareness of current and future economic, social and environmental pressures.

Continued tax reform undertaken in a coherent and fiscally responsible manner is crucial to sustaining Australia's economic prosperity and is central to building on the sense of equity and fairness that is part of the Australian way of life.

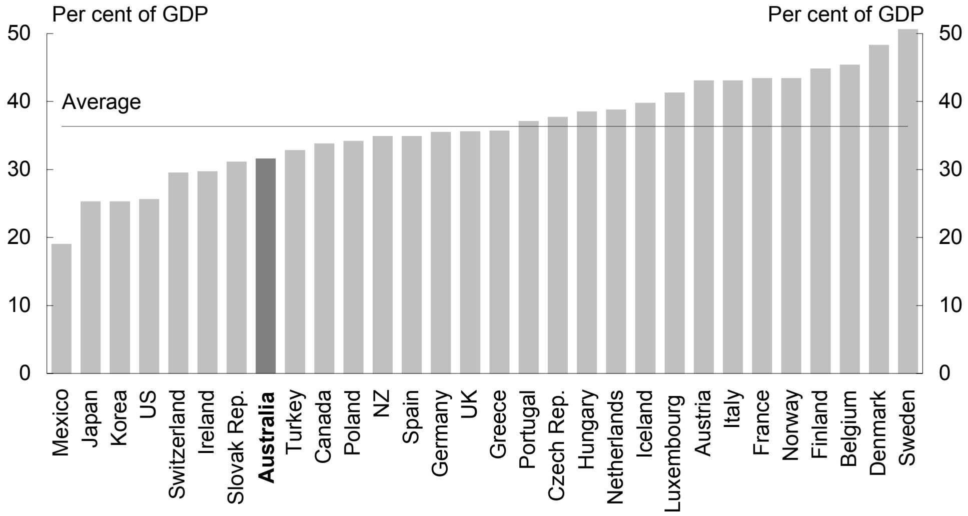
The Government has reshaped Australia's personal, business, indirect and international taxation landscape. The Government has delivered carefully designed packages such as *The New Tax System* and *More Help for Families* as well as delivering other elements of on-going reform through the annual budget. Balanced decisions have been made, including after reviews of the tax system, such as the Review of Business Taxation, Review of International Tax Arrangements and Review of Aspects of Income Tax Self-Assessment.

The International Comparison of Australia's Taxes was commissioned to help benchmark Australia's tax system with other developed countries. International comparisons inform good tax policy formulation by helping us learn from the analysis and experience of other countries, and allowing us to check whether features of our tax system may be hindering our competitiveness.

Major conclusions from the international benchmarking (see Box 2 for further details) were that:

- Australia is a low tax (see Chart 1) and low spend country, with most lower taxing countries, especially the United States and Japan, funding higher spending through large budget deficits;

Chart 1: Total tax burden for OECD countries, 2003[(a)]



(a) The OECD's measure of the tax burden is the total taxation revenue of national, state and local governments expressed as a percentage of gross domestic product. For Australia, the data are for the 2003-04 financial year, the latest year where comparable international data are available.
Source: OECD Revenue Statistics 1965-2004 (2005 Edition).

- Australia's mix between direct and indirect taxes is in line with other OECD countries, but the composition is different;

- on direct taxes:

  – Australia's overall level of taxation on wages and salaries is relatively low, although the composition is very different from other countries — Australia is one of only two countries without any social security taxes, with the result that Australia's individual income tax burden can appear high when partial comparisons are made with other countries. Our top marginal tax rate is slightly higher and the top rate threshold slightly lower than several other countries. Overall tax rates on families are low, but effective tax rates can be comparatively high because of our highly targeted welfare system;

  – on companies, Australia's company tax rate is on par with other countries but the business tax base appears to be broader in some areas; and

  - very few other countries have superannuation arrangements, and hence tax arrangements, of a similar nature to Australia; and

- on indirect taxes, Australia has a lower reliance on value-added and sales taxes, and a higher reliance on property and transactions taxes. Australia does not levy any wealth, estate, inheritance or gift taxes. Australia's taxes on petrol were the third lowest out of the 30 OECD countries.

While international benchmarking is a useful tool for focusing on particular areas of the tax system, policy decisions by government must consider the most appropriate choices given Australia's own history and culture as well as its social and economic challenges. For instance, the Government has ruled out any increase in the GST, or the introduction of any wealth, estate, inheritance or gift taxes. Some tax areas where Australia seems to lag are the responsibility of the States. The Australian Government has used the information in the *International Comparison of Australia's Taxes* to inform its choices in putting together the continuing tax reform package in this budget.

Box 1: Government's tax reform achievements

Some of the key taxation reforms undertaken by the Government in the last ten years include:

- removing the inefficient wholesales sales tax and state transaction taxes and replacing them with the GST;
- reforming the personal income tax scales;
- simplifying and increasing support for families;
- reducing the company tax rate from 36 to 30 per cent;
- introducing a consolidation regime for corporate groups;
- introducing the capital gains tax discount of 50 per cent;
- introducing the Australian Business Number system;
- reforming the treatment of personal services income;
- introducing capital gains tax concessions for small businesses and companies that undergo takeovers and demergers;
- creating a uniform capital allowance system replacing accelerated depreciation;
- introducing the Simplified Tax System for small businesses;
- reforming the international taxation arrangements;
- reforming elements of Australia's self assessment system following the Review of Aspects of Income Tax Self-Assessment; and
- ensuring the deductibility of 'blackhole' expenditure.

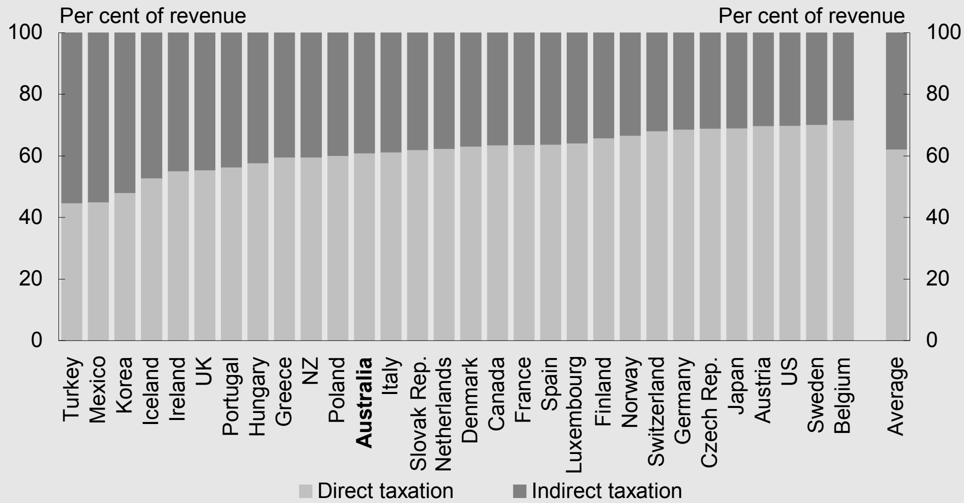
Further details about these reforms are included in Appendix A.

Box 2: International Comparison of Australia's Taxes

The International Comparison of Australia's Taxes (ICAT) was established to provide objective, descriptive information on Australia's tax system compared with that of other OECD countries. The ICAT examined taxes at national, state and local government levels. All major forms of taxation were considered.

Australia's mix between direct and indirect taxes is in line with other countries but the composition is different (see Chart 2). In Australia, 60.9 per cent of taxes are collected from direct taxes on incomes such as wages, salaries and profits (the OECD average is 62.2 per cent), with the remainder from indirect taxes such as the GST, excise and customs, and property and transaction taxes.

Chart 2: Direct and indirect taxation revenue as a proportion of total taxation revenue for OECD countries, 2003

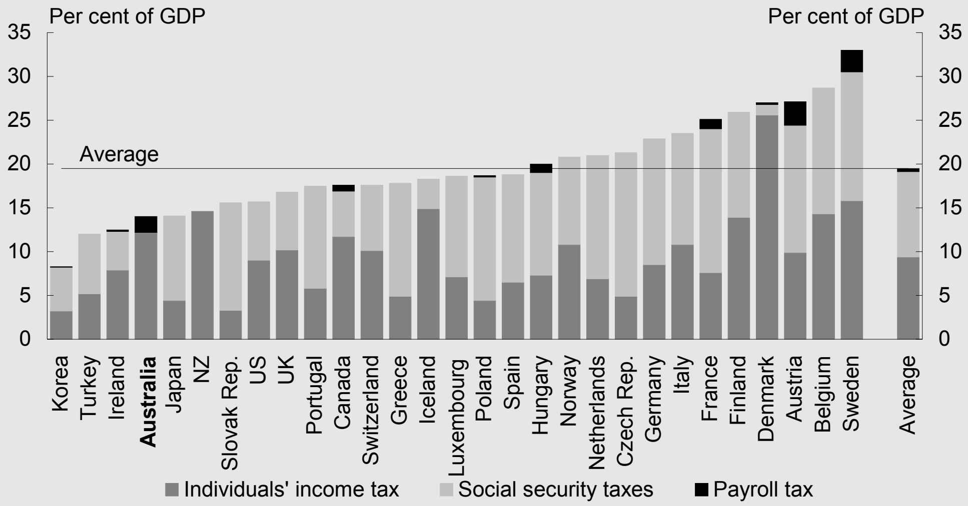


Source: OECD Revenue Statistics 1965-2004 (2005 Edition).

Box 2: International Comparison of Australia's Taxes (continued)

Australia's overall level of taxation on wages and salaries is relatively low at 14.0 per cent of GDP — this is significantly less than the OECD unweighted average of 19.5 per cent. As indicated in Chart 3, the composition of Australia's taxes on wages and salaries is very different from other countries. Australia is one of only two countries without any social security taxes (the other being New Zealand). This is the greatest difference between Australia's tax system and those of other developed countries. Chart 3 shows that these social security taxes are often the major source of taxation on wages and salaries — they can be at tax rates of over 30 per cent of wages and salaries, all on top of income taxes. These social security taxes can be paid by employees or employers. When paid by employers, the economic effects are very similar to payroll taxes.

Chart 3: Components of direct taxation in respect of individuals and payrolls, 2003



Source: OECD Revenue Statistics 1965-2004 (2005 Edition).

Australia's previous top marginal tax rate of 48.5 per cent was slightly higher and the previous top rate threshold slightly lower than other countries. Changes in this budget will move Australia's top marginal rate into line with the unweighted average (46.5 per cent relative to the average of 46.7 per cent), and the top threshold will move above the OECD average (see Chart 6).

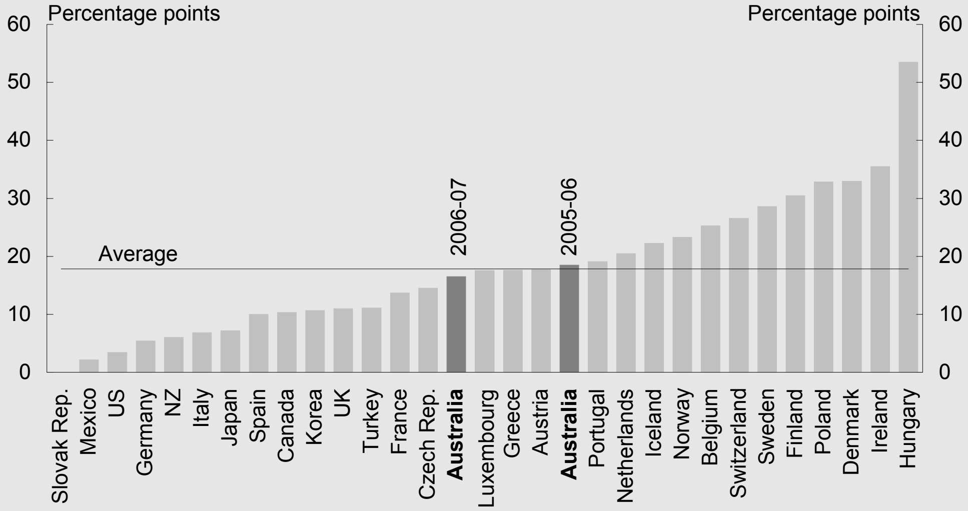
Box 2: International Comparison of Australia's Taxes (continued)

Overall tax rates on families are low. For all of the eight different types of single and family types considered by the OECD, Australia's average effective tax rate is in the lowest eight out of the thirty OECD countries. Effective tax rates in Australia can be comparatively high because of our highly targeted welfare system.

In measuring the impact of the tax system on companies, there are some classification issues in making international comparisons. With this qualification, Australia's overall tax collection from companies was the third highest in the OECD as a proportion of GDP. There are two possible sources for higher collections — either higher company tax rates or a larger company tax base. Australia's 30 per cent company tax rate is on par with other countries (unweighted average of 28.5 per cent). Even after allowing for the growth in company profits and Australia's increasing level of incorporation, Australia's company tax base appears to be broader than other countries. This budget includes measures that will slightly narrow the company tax base, either to improve efficiency by moving our depreciation arrangements closer to economic depreciation, or to reduce the compliance costs of small businesses.

As shown in Chart 4, the previous gap between Australia's top personal marginal tax rate and the company tax rate (18.5 per cent) was slightly above the OECD average (17.8 per cent). With the two percentage point reduction in the top personal tax rate announced in this budget, Australia is now slightly below the average.

Chart 4: Difference between top marginal tax rate and full statutory corporate tax rate for OECD countries, 2005



Source: OECD Tax Database (preliminary data); KPMG (various); Deloitte (2006); various country websites.

Box 2: International comparison of Australia's taxes (continued)

Apart from the absence of social security taxes, and Australia's targeted welfare system, the other major difference between Australia and other countries is our full imputation system with refundable credits.

The benefit of this arrangement for Australian resident shareholders is that double taxation of domestic income from companies is removed. As such, domestic source dividend income in Australia is generally taxed at a lower rate than most other OECD countries that only provide partial relief from double taxation.

This is a particular benefit for low to middle-income earners. For example, Australia's overall level of taxation on dividend income for a shareholder earning the average wage (31.5 per cent) is the second lowest of the ten countries examined in the report, and considerably lower than the average of 41.9 per cent.

On indirect taxes, Australia has a lower reliance on value-added and sales taxes (4.3 per cent relative to the OECD average of 6.8 per cent). Australia's GST rate of 10 per cent is below the OECD average of 17.6 per cent.

Australia has a relatively higher reliance on property and transactions taxes — the seventh highest in the OECD. Australia has the highest financial and capital and transaction tax burden of the 10 countries examined closely by the study.

Australia does not levy any wealth, estate, inheritance or gift taxes.

Australia's taxes on petrol were the third lowest out of the 30 OECD countries.

Throughout the 448 page report there are a number of boxes that provide additional comparative information on Australian taxes, for instance:

- US taxes on higher income earners are often greater than in Australia, but this depends on where you live (see ICAT, Box 4.3).

- 'Flat taxes' in Eastern Europe are often far from flat, and once social security contributions are included, can impose higher levels of tax on wages and salary earners than does Australia (the case of the Slovak Republic is discussed where, despite a 'flat income tax' of 19 per cent, the total tax burden on average wages is 42 per cent) (see ICAT, Box 4.4).

The ICAT report is available at http://www.comparativetaxation.treasury.gov.au.

KEY DRIVERS OF THE GOVERNMENT'S ONGOING TAX REFORM AGENDA

On achieving office in 1996, the Government set a fiscal objective of not increasing the overall tax burden from 1996-97 levels. The Government has observed that objective and, since 2000, has substantially reduced the tax burden from 1996-97 levels as part of major structural tax reform. The Government's tax reforms have been strongly supportive of sustained economic growth while at the same time promoting equity and reducing tax system complexity. The key drivers of the Government's ongoing tax reform agenda have been:

- improving incentives to work;
- improving incentives to save and invest;
- improving resource allocation;
- reducing complexity;
- recognising the contribution of families; and
- ensuring the sustainability of the revenue base.

These drivers are also important in the development of policy to address Australia's future demographic challenges.

Improving incentives to work

Australians' decisions on whether to work and how long to work are influenced by the tax system, the provision of income support and retirement incomes policies. It is important that government policies do not discourage people from working.

Paid work provides individuals with substantial benefits. It provides them with the means to satisfy their needs and those of their families, the opportunity to develop personally, live independent lives and interact socially. In addition, labour force participation is a key driver of economic growth.

Ensuring that the tax and income support systems provides an adequate balance between equity and fairness, and assistance for those in need without providing disincentives to work, requires careful consideration.

The measures announced in the 2006-07 Budget will boost incentives to work in a number of ways.

The increase in the 30 per cent tax threshold from $21,601 to $25,001, in addition to the substantial increase in the Low Income Tax Offset, will increase incentives for workforce participation, particularly for secondary income earners who are arguably more responsive to changes in tax.

The reduction in the top tax rates to 40 per cent and 45 per cent and the increase in the top tax thresholds, all from 1 July 2006, will enhance the international competitiveness of Australia's personal income tax arrangements. Maintaining the competitiveness of our personal tax system is important for sustaining workforce participation and productivity in Australia.

The Government has carefully considered the impact of the budget on effective tax rates. Australia has a highly targeted welfare system. Its Family Tax Benefit system recognises that households with children face greater costs than those without. Family Tax Benefit Part A (FTB (A)) is directed towards those families with lower incomes. The necessary implication of targeting benefits is that as these benefits are withdrawn, effective marginal tax rates are increased. The alternatives are either not to provide these benefits (thereby leaving beneficiaries much worse off) or else creating universal entitlement systems with the higher spending, higher taxing and greater churning that is integral to such systems.

Although our targeted tax and welfare systems necessarily create higher effective marginal tax rates, the Government seeks to identify and act where it can to reduce these and minimise their impacts. For instance, the higher threshold for FTB (A) ($40,000) was carefully chosen so that it did not overlap with the phase-out of the Low Income Tax Offset (now $40,000). The reduction in the Medicare levy phase-in rate from 20 per cent to 10 per cent for low-income earners has important impacts on effective tax rates for low-income earners.

Effective marginal tax rates have been significantly decreased for families over recent years. For example, before 2000-01, families faced a 50 percentage point increase in their effective marginal tax rates from the withdrawal of family payments above the base amount. *The New Tax System* of 2000-01 reduced this withdrawal to 30 percentage points. In 2004-05 the withdrawal rate was reduced to 20 percentage points.

It is also important that retirement incomes policy does not encourage early retirement. Australia has one of the lowest participation rates in the OECD for those over age 55.

The Government's plan for superannuation would encourage older Australians to remain in the workforce. Under the plan, superannuation benefits from taxed funds received after age 60 would not be included in a person's assessable income for tax purposes, which may reduce the tax paid on work income. Further, the assets test taper rate for the age pension would be reduced, removing the current disincentive towards working and saving stemming from the possibility of a person losing more age pension than they can earn from additional savings.

Improving incentives to save and invest

Improving incentives to save and invest is an important element of the Government's pro-growth policies and strategy for addressing the demographic challenges facing Australia over the coming decades.

Taxation is only one of a number of factors that are taken into account when making saving and investment decisions. Still, the tax and superannuation systems do affect saving and investment behaviour.

At the aggregate level, saving is important because it provides resources to fund investment. Investment is a key element of productivity growth and hence of economic growth.

At the individual level, saving provides individuals with the means to fund future consumption and in particular their retirement. The importance of private saving for retirement purposes is increasing. Australians are generally spending a longer period in full-time education, retiring earlier and living longer. As a result, the number of years spent in the workforce has proportionately declined whereas the potential costs of retirement have increased.

The Government's proposed changes to the retirement income system, in addition to the other measures announced in this budget, would increase incentives to save and invest in Australia and encourage greater innovation and entrepreneurship. This in turn would improve productivity and economic growth.

The removal of benefits tax and the halving of the pension assets test taper rate would provide significant incentives to save. Further, the reductions in personal income tax will increase the return from all forms of saving by individuals.

The changes to the tax depreciation rates will increase incentives for business to undertake investment in new plant and equipment that is necessary for them to keep pace with new technology and remain competitive. The budget also contains a package of measures aimed at encouraging investment in the venture capital industry.

Improving resource allocation

The aggregate level of savings and investment is a key factor in economic growth. Even more important is the quality and effectiveness of the saving and investment undertaken.

The tax system affects resource allocation within the economy. Where effective tax rates differ between options to save and invest, saving and investment will be shifted from those that are relatively highly taxed to those that are lower taxed. This will distort the pattern of saving and investment, leading to inefficient resource allocation.

As individuals do not all have the same access to saving and investment options, tax distortions can also have distributional implications.

The Government's tax policy strategy is to ensure that the tax system has minimal effect on allocation of resources in the economy. An exception to this is where the tax system is used to address a market failure, such as the case with respect to retirement incomes and the demonstrated tendency for people to under-provide for their retirement.

In order to improve resource allocation in the economy the Government will increase depreciation rates under the diminishing value method to align depreciation deductions for tax purposes more closely with the actual decline in the economic value of an asset.

Reducing complexity

A certain level of complexity will always be associated with raising revenue on a broad series of transactions and a wide and diverse population base. Even the simplest tax system will be associated with a rising level of complexity as markets become more and more sophisticated.

Nevertheless, it is important to ensure that the tax system is as simple as possible. Complexity increases the costs of transactions, which in turn reduces production possibilities and consumption opportunities.

In recognition of the potentially significant economic and social costs of complexity, the Government established the Taskforce on Reducing Regulatory Burdens on Business (the Taskforce) in October 2005. Commissioned to examine and report on areas where regulatory reform can provide significant immediate gains to business, the formation of the Taskforce was a further indication of the Government's commitment to reducing the burden of regulatory activity.

In April 2006, the Government issued an interim response to some of the Taskforce's recommendations, including reforms to fringe benefits tax that the Taskforce had identified as a priority for reducing tax complexity for business. This budget builds on those announcements, with a range of measures directed at further reducing the complexity faced by small business. These include changes to make the Simplified Tax System even more attractive, aligning thresholds for small businesses to make it easier for them to understand their eligibility, and simplifying and extending access to capital gains tax concessions.

Announced with this budget, the Government's plan to simplify and streamline superannuation is a fundamental reform responding to the Taskforce themes of reducing complexity and the compliance burden. The complexity of the existing superannuation tax arrangements means that an individual approaching retirement often needs to seek financial advice before making a decision on how to take their superannuation benefits. Independent evidence given to the House Standing Committee on Economics, Finance and Public Administration inquiry into improving superannuation savings of people under 40 stated that the cost of this financial advice could be in the order of $3,000 to $10,000 depending on the complexity. The Government's plan for the superannuation system would remove the current raft of complex tax arrangements that apply to individual superannuation benefits and would dramatically simplify superannuation for retirees as well as reducing the compliance burden facing superannuation funds.

Recognising the contribution of families

The Government recognises the importance of the contribution of families in Australian society. The 2006-07 Budget builds on the Government's *More Help for Families* initiative, providing further assistance to families with children, to help them balance work and family responsibilities. Improvements in FTB (A) rates and income tests have directly benefited the family budgets of over 1.8 million Australian families.

In this budget, the Government is expanding the number of families eligible for the maximum rate of FTB (A). The threshold where families lose eligibility to the maximum rate will be increased from $33,361 to $40,000 from 1 July 2006. It is expected that this measure will assist almost half a million families annually.

To illustrate the changes, in 2000-01 a family with a private income of $40,000 and one child under 13 would have received $975 in FTB (A). In 2005-06, this family receives $2,873. In 2006-07, this family is estimated to receive $4,318 — an improvement of a further $1,445.

In addition, the Government has decided that the Large Family Supplement to the Family Tax Benefit should be extended to all families with three children, where it was previously available only to families with four or more children. This measure will benefit around 440,000 families.

Ensuring the sustainability of the revenue base

Australian Government finances are strong. In this budget the Government has forecast its ninth budget surplus in 2006-07. Further, Australia is now one of only a few countries among the OECD with negative net public debt.

Nevertheless, the Government's Intergenerational Report 2002-03 projects that over the next 40 years Australia's steadily ageing population is likely to place significant pressure on Australian Government finances. This ageing of the population is expected to have a profound effect on the economy and, potentially, on our living standards.

In order to ensure future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation, changes to the tax system must have regard to the longer-term sustainability of the revenue base.

Continuing Tax Reform

The process of protecting the revenue base is an on-going one. This budget includes five measures, estimated to protect over $2.3 billion in revenue over the forward estimates period, to improve the integrity of the tax base. If major issues emerge about the integrity of the tax base, the Government stands ready, as it has done with 'Operation Wickenby', to provide the resources to ensure that everyone pays their correct level of taxes.

CONTINUING SUPERANNUATION REFORM

A PLAN TO SIMPLIFY AND STREAMLINE SUPERANNUATION

The Government is proposing a plan aimed at dramatically simplifying superannuation and improving the retirement incomes of the more than 10 million Australians with superannuation accounts.

The Government's proposed plan would:

- simplify and streamline superannuation arrangements;
- improve incentives to work and save; and
- introduce greater flexibility in how superannuation savings can be drawn down in retirement.

The Government has provided $6.2 billion over three years in the budget for the plan.

The Government has already introduced a number of major reforms to superannuation, including choice of fund, portability and the Government co-contribution. With over $800 billion in assets the superannuation industry is a major part of the financial system and of crucial importance to the retirement aspirations of all Australians.

But Australia's superannuation system is complex. Complexity confuses retirement decisions, clouds the incentive to invest in superannuation and imposes unnecessary costs. The report of the Taskforce on Reducing Regulatory Burdens on Business recommended that the Government give high priority to comprehensive simplification of the tax rules for superannuation. The Government's plan would sweep away the current raft of complex tax arrangements that apply to Australians' superannuation benefits.

Simpler, easier to understand, taxation arrangements

Under the plan, from 1 July 2007:

- Superannuation benefits paid from a taxed fund (over 90 per cent of fund members) either as a lump sum or a pension would be tax-free for people aged 60 and over.
  - A person aged less than 60 would, as now, be taxed on their benefits but under streamlined arrangements.

  - Benefits paid from an untaxed fund (mainly to public servants) would still be taxed although where the retiree was aged 60 and over the rate would be lower than now.

  - Reasonable benefit limits (RBLs) would be abolished.

- The concessional tax arrangements for superannuation contributions and earnings would remain. Age-based restrictions limiting tax deductible superannuation contributions would be replaced with the introduction of a streamlined set of rules.

  - The superannuation preservation age would not change. The preservation age is already legislated to increase from 55 to 60 between 2015 and 2025.

Currently, Australia applies tax on contributions, earnings and benefit payments. In 1988, the then Government brought forward part of the tax which was previously applied to end benefits. This dramatically exacerbated the complex tax treatment of superannuation in Australia. The recent report on the *International Comparison of Australia's Taxes* noted that Australia's superannuation system is concessionally taxed, though it is unusual in having three tax points. The Government's proposal is to remove the tax on end benefits because it is the most complicated. The complex rules applying to the taxation of end benefits make it extremely difficult for anyone to understand how their benefits will be taxed, creating unnecessary confusion and costs and adversely affecting the efficiency and effectiveness of the retirement income system.

The removal of benefits tax would greatly assist people in planning for their retirement by introducing a simpler and more streamlined system for both those retiring and those considering further contributions. It would also reduce significant associated 'red tape' for the superannuation industry.

Improving incentives to work and save

Improving rewards for working and saving is an important component of the Government's pro-growth policies and strategy for addressing the demographic challenges facing Australia over the coming decades.

Incentives to work, save or retire are affected by various factors, including the rules concerning when people can access their superannuation and the impact of savings on their age pension entitlement. It is important that the retirement income system does not encourage people to leave the workforce early.

The removal of benefits tax would increase retirement incomes and encourage pre-retirement savings (see Table 1). Other aspects of the plan would further boost retirement incomes and encourage savings:

- The self-employed would be able to claim a full deduction for their superannuation contributions as well as being eligible for the Government co-contribution for their post-tax personal contributions.
- The ability to make deductible superannuation contributions would be extended to age 75.
- The pension assets test taper rate would be halved to $1.50 per fortnight from 20 September 2007 — the current rate provides a significant disincentive to save because of the impact of higher savings on reducing age pension entitlements.

Table 1: Potential impact of the plan on a person's retirement income

Average weekly earnings $	Projected retirement income before plan ($ per week)(a)	Increase in average retirement income ($ per week)(a)(b)	Increase in average retirement income with additional saving of 5 per cent of earnings ($ per week)(b)
400	705	31	96
600	750	59	153
800	778	95	180
1,000	798	136	192
1,500	886	192	210
2,000	1,024	199	290

(a) These are the benefits a person would achieve if they received employer contributions of nine per cent of earnings for 40 years and retire at 65.
(b) Includes the increase in age pension and superannuation pension when the person takes the minimum amount from an allocated pension.

The plan also removes disincentives for older Australians to remain in the workforce. With superannuation benefits tax-free from age 60, there would be an incentive to remain in the workforce longer. In addition, as superannuation benefits would no longer be included in a person's assessable income for tax purposes this may reduce the tax paid on their work income, providing further incentive to work.

Greater flexibility in drawing down benefits

Under the plan, individuals would have greater flexibility as to how and when to draw down their superannuation in retirement. There would be no forced payment of superannuation benefits. This builds on earlier Government initiatives to make superannuation more flexible and adaptable to the needs of individuals.

Sustainability

With the ageing of the population it is also important that changes to taxation arrangements are sustainable. The plan provides simplicity benefits for retirees, participation effects and improvements to retirement incomes that are superior to other options, such as removing the tax on contributions. The cost of removing the tax on contributions along with the proposed reforms to the pension assets test would be considerably greater than the cost of the proposed package. Removing the tax on contributions does not have the same benefits on participation as the removal of benefits tax. This will be an increasing priority as the workforce ages. Such alternatives also fail to bring the considerable simplicity and other benefits of the Government's plan.

The plan impacts positively on all three pillars of Australia's retirement income system. These three pillars comprise:

- a taxpayer funded means-tested age pension;
- a minimum level of compulsory employer superannuation contributions; and
- voluntary private superannuation and other savings.

Reducing taxation increases the benefits flowing from compulsory superannuation guarantee contributions and the plan also provides new incentives to make voluntary contributions. In addition, the reduction of the assets test taper rate improves the operation of the age pension pillar of Australia's retirement income system.

Making it easier to find and transfer superannuation benefits

The Government has already significantly improved the ability of people to manage and control their superannuation through the introduction of choice of fund (allowing employees to choose the fund for employer contributions) and portability (allowing people to move existing benefits from one fund to another). But practical difficulties can make transferring and consolidating accounts difficult and members can lose contact with their superannuation fund.

To make finding, transferring and consolidating accounts simpler, the Australian Taxation Office (ATO) would take on a more active role. The ATO would contact people with lost accounts and provide them with a simple standard form to complete if they wish to consolidate their accounts. The ATO would then organise the consolidation, avoiding the need for the individual to deal with multiple funds with different procedures.

To streamline the transfer of benefits it is also proposed to reduce the maximum 90 days for funds to process a transfer request to 30 days and introduce a standard form (including standardised proof of identity checks) for individuals to complete should they wish to make their own arrangements through their fund to transfer benefits.

CONTINUING PERSONAL TAX REFORM

The personal tax reforms announced in this budget encompass a significant restructure of personal income tax, improvements to Family Tax Benefit Part A (FTB (A)), the streamlining of the tax return process, simplification of income tax arrangements for individuals ceasing full-time education for the first time and greater flexibility for employee share schemes. In total, these reforms are worth $38.3 billion.

PERSONAL INCOME TAX REDUCTIONS

Reductions of $36.7 billion over four years

The Government has always regarded an efficient, equitable and effective personal income tax system as important to encourage workforce participation and keep Australia's income tax system internationally competitive.

In 2000, *The New Tax System* represented a major restructuring of the Australian tax system with the largest personal income tax cuts in Australia's history, amounting to $12 billion per annum. Since then the Government has continued its commitment to tax reform and has provided further reform of personal income tax rates and thresholds in the 2003-04 (tax cuts of $10.7 billion over four years), 2004-05 (further cuts of $14.7 billion over four years) and 2005-06 Budgets (a further $21.7 billion over four years). The 2006-07 Budget builds on this and provides the largest tax cuts since *The New Tax System*.

From 1 July 2006, the Government will further reduce personal income taxes by $36.7 billion over four years.

This involves changes to personal income tax rates, thresholds, the Low Income Tax Offset (LITO), the Medicare levy phase-in rate and the fringe benefits tax rate.

These tax cuts provide further incentives for workforce participation and improve the international competitiveness of Australia.

Table 2 provides a summary of the changes to the rates and thresholds and a comparison with the tax scales prior to *The New Tax System* (TNTS).

Table 2: Comparison of the new tax rates

Pre-TNTS tax thresholds Income range ($)	Tax rate %	Current tax thresholds Income range ($)	Tax rate %	New tax thresholds from 1 July 2006 Income range ($)	Tax rate %
0 - 5,400	0	0 - 6,000	0	0 - 6,000	0
5,401 - 20,700	20	6,001 - 21,600	15	6,001 - **25,000**	15
20,701 - 38,000	34	21,601 - 63,000	30	**25,001** - **75,000**	30
38,001 - 50,000	43	63,001 - 95,000	42	**75,001** - **150,000**	**40**
50,001 +	47	95,001 +	47	**150,001** +	**45**

Improving incentives to work

The increase in the 30 per cent threshold from $21,601 to $25,001 will enable low-income earners, including part-time workers, to keep a higher proportion of their earnings. Low-income earners will be further assisted through a substantial increase in the LITO. Those eligible for the full LITO will not pay tax until their annual income exceeds $10,000 (up from $7,567). In addition, the LITO will not begin to phase-out until a taxpayer's annual income exceeds $25,000. Taxpayers will now be able to benefit from some LITO up to incomes of $40,000. In addition, the phase-in rate for the Medicare levy has been reduced from 20 per cent to 10 per cent enabling more low-income taxpayers to pay a reduced rate of Medicare levy.

Senior Australians eligible for the Senior Australians Tax Offset and the LITO currently do not pay tax until an annual income of $21,968 for singles and $36,494 for couples (depending on the income earned by each member of the couple). The effect of the tax cuts is to lift these income levels up to $24,867 for singles and $41,360 for couples. The seniors Medicare levy threshold will also increase so that senior Australians do not pay the Medicare levy until they begin to incur an income tax liability.

The highest marginal tax rate will be cut from 47 per cent to 45 per cent and the threshold will rise from $95,001 to $150,001 from 1 July 2006. Taxpayers will not reach the highest marginal tax rate until they earn more than three times average weekly earnings. From 1 July 2006, the top marginal tax rate will apply to around 2 per cent of taxpayers. The second top marginal tax rate will be reduced from 42 to 40 per cent and the threshold at which it cuts in will increase from $63,001 to $75,001 from 1 July 2006.

If the threshold for the top marginal tax rate had been indexed for inflation since 1996, it would have moved from $50,001 to less than $66,000 by 1 July 2006. Under the announcements made in this budget, it will be $150,001. If the threshold for the second top marginal tax rate had been indexed for inflation since 1996, it would have moved from $38,001 to less than $49,000 by 1 July 2006. Under the announcements made in this budget, it will be $75,001.

These tax cuts will also ensure that over 80 per cent of Australian taxpayers face a top marginal tax rate of 30 per cent or less. Moreover, a taxpayer will need to earn $121,500 to pay an average tax rate of 30 per cent.

These tax cuts provide significant improvements to the incentive to work and, in conjunction with the superannuation package, also improve incentives to save.

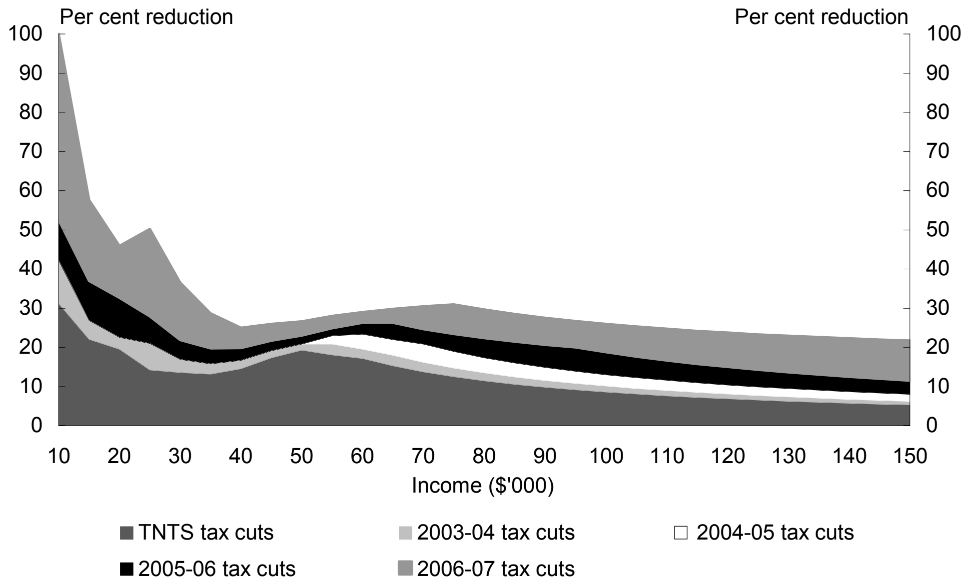
Change in the personal tax burden over time

The tax cuts provided by the Government have delivered a dividend to all Australian taxpayers:

- Taxpayers earning $25,000 prior to *The New Tax System* will, from 1 July 2006, have had a reduction in income tax of around 50 per cent (excluding the Medicare levy) since 2000.
- Taxpayers earning $65,000 prior to *The New Tax System* will, from 1 July 2006, have had a reduction in income tax of around 30 per cent (excluding the Medicare levy) since 2000.
- Taxpayers earning $100,000 prior to *The New Tax System* will, from 1 July 2006, have had a reduction in income tax of around 26 per cent (excluding the Medicare levy) since 2000.

Chart 5 illustrates in percentage terms that the greatest tax cuts have been provided to low-income earners.

Chart 5: Income tax savings since *The New Tax System*



Source: Treasury estimates.

These tax cuts provide tax relief to all taxpayers whilst preserving the progressivity of the Australian tax system and maintaining the sustainability of the revenue base.

The concept of progressivity is based on the principle of vertical equity — that is, those in a position to make a comparatively greater contribution to raising revenue should do so. The Government considers that this is the appropriate system for Australia and this package is consistent with these principles by ensuring that those taxpayers on the lowest incomes receive the greatest percentage reduction in tax.

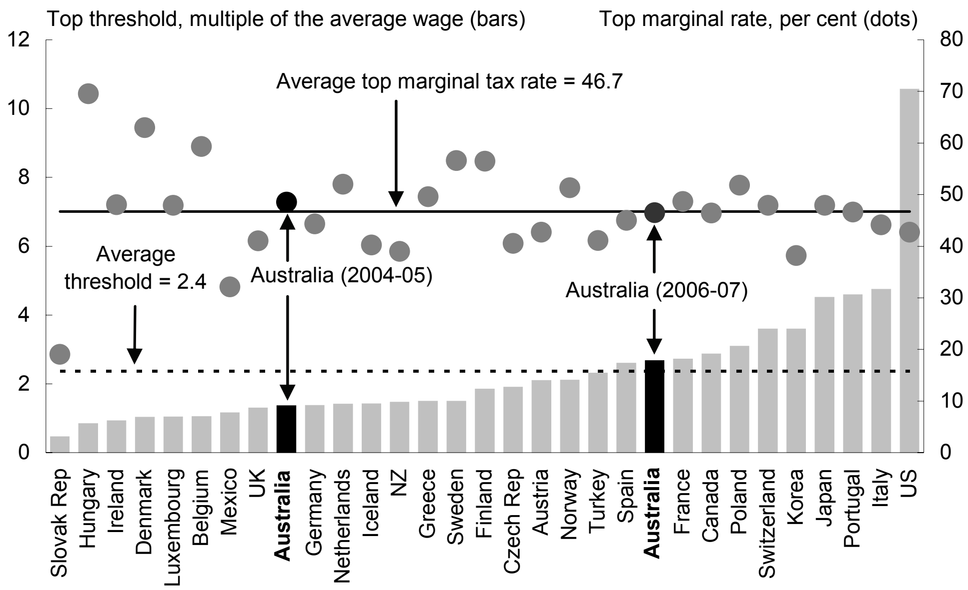
International comparisons

The recent *International Comparison of Australia's Taxes* found that Australia's total wage and salary tax take as a proportion of GDP is low compared with other OECD countries.

The report noted that Australia's top marginal tax rate of 48.5 per cent (including the Medicare levy) was slightly higher than the average top marginal tax rate for the OECD. Australia's threshold to which the top marginal tax rate applies was slightly below the OECD average.

From 1 July 2006, Australia's top marginal tax rate of 46.5 per cent (including the Medicare levy) will be in line with the OECD average of 46.7 per cent. The increase in the top threshold will mean that Australia has the tenth highest threshold in the OECD.

Chart 6: Comparison of top tax rates and thresholds across the OECD [(a)]



(a) The OECD average wage is for a worker engaged in full-time manual or non-manual labour across a range of industries.
Source: OECD Tax Database (preliminary data).

These changes will improve the international competitiveness of Australia's tax system, enhancing our reputation as a low taxing country.

RECOGNISING THE CONTRIBUTIONS OF FAMILIES

Family Tax Benefit improvements

The Government has always regarded improving the wellbeing of families with children as an important objective. To this end, the Government has significantly enhanced the family payments system on a number of occasions. Since 1996, the Government has almost doubled the maximum rate families can receive in per child assistance.

In 2005-06, families can receive $4,201 per child per year, but they stop being eligible for this maximum rate of FTB (A) if they earn more than $33,361. The 2005-06 Budget provided an increase in this limit to $37,500 from 1 July 2006. This budget includes almost $1 billion further to increase the limit to $40,000 from 1 July 2006 and allow even more families to receive the maximum rate. It is expected that this measure will assist almost half a million families annually.

Families with four or more children now receive the Large Family Supplement for the fourth and each subsequent child. From 1 July 2006, families will receive the large family supplement for the third child and each subsequent child at a cost of around $500 million over four years.

In *The New Tax System*, the Government introduced the Family Tax Benefit to replace, and improve upon, a diverse range of payments and tax offsets. Critical changes since 2000-01 to Family Tax Benefits have included:

- introducing a $600 indexed supplement to FTB (A) from 1 July 2003;
- lowering the maximum rate taper from 30 per cent to 20 per cent from 1 July 2004; and
- increasing the maximum rate families can receive in per child assistance from $3,029.50 per child in 2000-01 to $4,318 in 2006-07 under FTB (A).

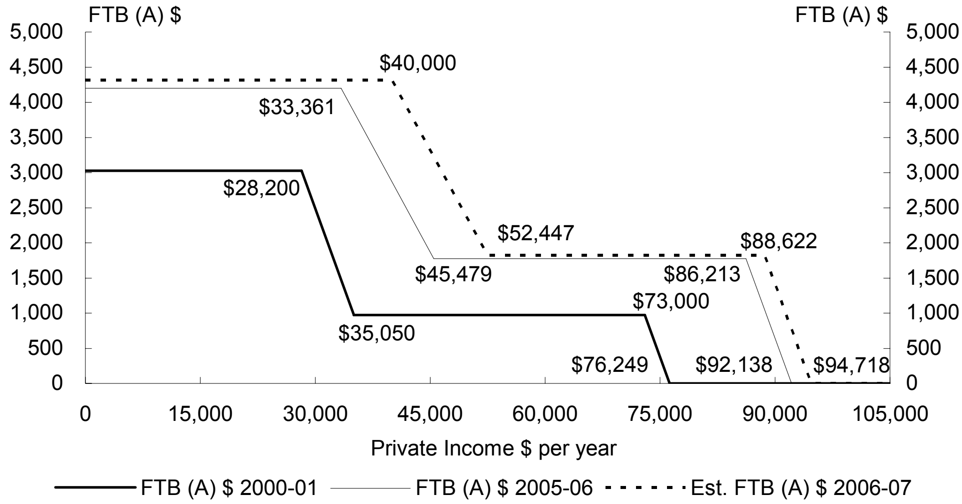
Improvements in FTB (A) rates and income tests have directly benefited the family budgets of over 1.8 million Australian families. The changes to the FTB (A) income test thresholds and taper rates have also improved the work incentives for these families.

Chart 7 shows the increases in amounts of payment, increases in income test thresholds and reduction in the taper rate for FTB (A) for a family with one child since 2000-01.

To illustrate the changes, in 2000-01 a family with a private income of $40,000 and one child under 13 would have received $975 in FTB (A), in 2005-06 they receive $2,873 and in 2006-07 they are estimated to receive $4,318 — an improvement of $1,445.

Chart 7: Family Tax Benefit Part A amount: 2000-01; 2005-06; estimated 2006-07

Family with one child under 13



Source: Treasury estimates.

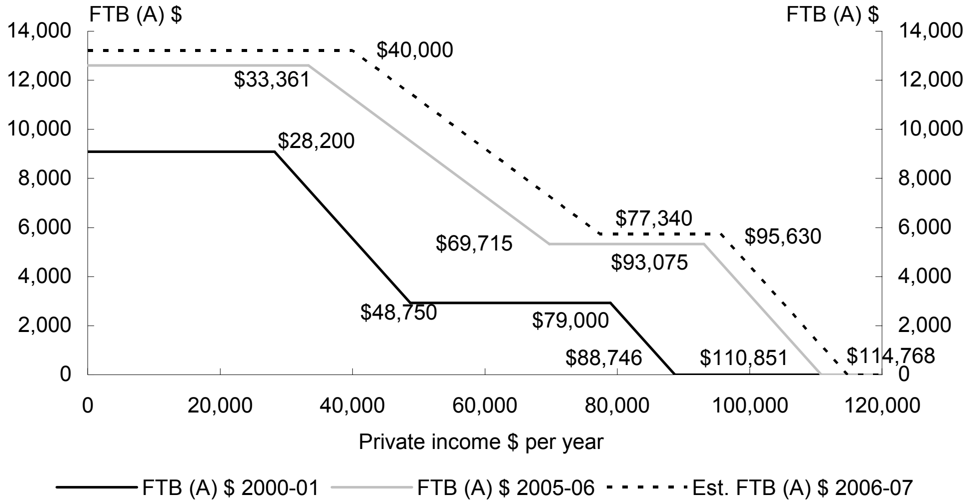
The extension of the Large Family Supplement for the third child in each family will benefit over 440,000 families.

Chart 8 shows the changes since 2000-01 in family payments for a family with three children. From 1 July 2006, families with three children will benefit from the change in the maximum rate income test threshold to $40,000 and from the large family supplement estimated to be $255.50.

To illustrate the changes, in 2000-01 a family with a private income of $40,000 and three children under 13 would have received $5,549 in FTB (A), in 2005-06 they receive $11,275 and in 2006-07 they are estimated to receive $13,209 — an improvement of $1,934.

Chart 8: Family Tax Benefit Part A amount: 2000-01; 2005-06; estimated 2006-07

Family with three children under 13



Source: Treasury estimates.

REDUCING COMPLEXITY

Streamlining personal income tax returns

The preparation and lodgement of personal income tax returns can be complex and time-consuming. The Government is aware of the importance of pursuing options to simplify the process for taxpayers.

The Australian Taxation Office (ATO) is working on streamlining the process of preparing a tax return, including through expanding the use of e-tax and more electronic lodgement options that will allow taxpayers to fill electronically various components of their returns by downloading information directly into their e-tax returns.

This year, taxpayers will be able to download electronically information on Centrelink benefits including information relevant for the Child Care Tax Rebate and medical expenses recorded by Medicare Australia, and the ATO will trial allowing taxpayers to download bank interest amounts from the major banks. Trials of electronic data provision for e-tax returns have so far been well received.

The Government will provide $10 million over two years in additional funding to accelerate the ATO’s programme of providing tax return information electronically, to include additional trials in 2007-08 and 2008-09. The programme will allow taxpayers to download information, such as dividend distributions from share registers, directly into their e-tax return. This will make preparing a tax return simpler and easier for taxpayers.

Remove the part-year tax-free threshold

With the same objective of reducing complexity and an unnecessary compliance burden on taxpayers, the Government will remove the part-year tax-free threshold where a person ceases full-time education. This will extend the full tax-free threshold of $6,000 to all resident taxpayers who cease full-time education for the first time. Such a change reduces compliance costs by removing the requirement for those taxpayers to calculate a part-year tax-free threshold and eliminating the need to isolate income (and any deductions) attributable to the period during which a taxpayer was engaged in full-time education. The changes also improve incentives to work in the first year after finishing study.

Extend current employee share scheme concessions to stapled securities

Currently, employees participating in an employee share scheme can only access the tax-deferred or the tax-upfront concessions where the employer provides ordinary shares. By extending the employee share scheme and related capital gains tax provisions to stapled securities that include an ordinary share and that are listed on the Australian Stock Exchange, the Government will increase the accessibility of employee share schemes — to the benefit of a broader range of employees and employers — and reduce the complexity and costs faced by employers in providing stapled securities to their employees.

CONTINUING BUSINESS TAX REFORM

As a result of measures announced in the 2006-07 Budget, the Government will reduce taxes on business by $4.2 billion over four years. The changes will improve the incentives for businesses to invest in plant and equipment, provide additional incentives to invest in the venture capital industry and significantly reduce the complexity of the tax system for small business.

The Government will encourage additional and more efficient investment in new plant and equipment by increasing the diminishing value rate for determining depreciation deductions from 150 per cent to 200 per cent (referred to as 'double declining balance') for all eligible assets acquired on or after 10 May 2006.

The Government will simplify the tax system for small business by aligning eligibility thresholds for a range of small business tax arrangements, increasing fringe benefits tax thresholds and widening access to the small business capital gains tax concessions for the owners of small businesses.

The Government will also introduce a suite of new measures to encourage venture capital investment.

BUSINESS TAX REFORM

A key objective of the Government's approach to business taxation reform has been to create an environment for achieving higher economic growth and a sustainable revenue base through an efficient, competitive and fair business tax regime.

The Review of Business Taxation undertaken in 1998 and 1999 resulted in significant improvements to Australia's business tax system. Most of the reforms following the review have centred on broadening the tax base, reducing tax rates and reducing tax system complexity. The reforms included:

- substantial reductions in the corporate tax rate from 36 per cent to 30 per cent over two years;
- introduction of the consolidation regime, enabling wholly-owned groups to be treated as a single entity with effect from 1 July 2002;
- reducing the tax compliance burden on small business and extending tax relief to these taxpayers through the Simplified Tax System (STS);
- tax relief for demergers;
- the simplified imputation system;

- the entrepreneur's tax offset;
- ensuring the deductibility of business 'blackhole' expenditure;
- advancing work on the taxation of financial arrangements; and
- reforming international taxation arrangements.

Following the Review of Business Taxation the Government also removed accelerated depreciation and aligned tax depreciation rates to an asset's effective life. This met two broad policy objectives: to fund substantially a reduction in the company tax rate and to remove tax-induced distortions to investment decisions. The measure builds on this reform ensuring tax depreciation more closely aligns with the way assets actually decline in value.

IMPROVING AUSTRALIA'S DEPRECIATION ARRANGEMENTS

The Government will increase the diminishing value rate from 150 per cent to 200 per cent for depreciating assets. The new rate will apply to eligible assets acquired on or after 10 May 2006, regardless of the asset's effective life.

This measure provides a direct benefit to Australian businesses of $3.7 billion over the next four years. Importantly, it ensures that Australian businesses have the right incentive to undertake investment in new plant and equipment that is necessary for them to keep pace with new technology and remain competitive. It will also improve resource allocation by aligning depreciation deductions for tax purposes more closely with the actual decline in the economic value of assets.

Depreciation and the tax system

Depreciating assets are assets that can reasonably be expected to decline in value over time. The tax system recognises this decline in value by allowing deductions for the cost of assets used in the production of assessable income. The current effective life depreciation arrangements are directed at allowing the taxpayer to deduct an estimate of the actual decline in the value of the asset each year.

There are assets that wear out more rapidly in the early years of use. For these assets, taxpayers can use the diminishing value method to determine deductibility, and concentrate deductions in the initial years in which an asset is held. The prime cost (straight-line) method of depreciation is available for assets that wear out evenly over time. Generally, taxpayers have a choice between the diminishing value and prime cost methods.

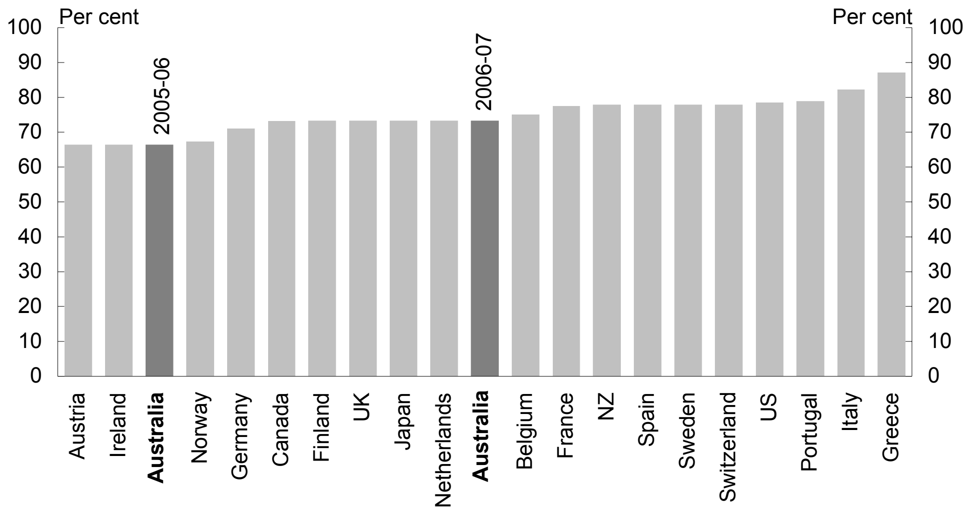
The diminishing value rate was 150 per cent of the prime cost for all applicable assets. As noted in the report *International Comparison of Australia's Taxes*, approaches to depreciation differ across countries. However, of the 10 OECD comparator countries studied, Australia had the equal lowest present value of depreciation allowances for an eight-year asset.

Several of the comparator countries have a diminishing value rate of 200 per cent. Academic studies suggest that a diminishing value rate of 200 per cent may more closely approximate the actual decline in the economic value for assets generally.

To ensure that depreciation rates are competitive in a world of rapidly advancing technology, the diminishing value rate has been increased to 200 per cent.

Chart 9: Present value of depreciation as a proportion of initial purchase price[(a)]

Eight-year asset — selected countries



(a) The present value figures do not include the value of investment allowances.
Source: Devereux, MP, Griffith, R and Klemm, A. (2002) 'Corporate income tax reforms and international tax competition' *Economic Policy*, 35, 451-495, Institute of Fiscal Studies http://www.ifs.org.uk/publications.php?publication_id=3210 and Treasury estimates.

As shown in Chart 9, this measure will bring Australia more into line with other comparable countries, enhancing the international competitiveness of Australian business.

This reform is not a reintroduction of accelerated depreciation, available in some countries, which can distort resource allocation. Instead, it builds on the reforms of the Review of Business Taxation, which focused on the key issue of aligning depreciation with the effective life of an asset. This reform will provide a more neutral arrangement across depreciating assets by bringing the rate of depreciation for tax purposes more closely into line with economic depreciation.

Improving incentives to invest

Increasing the diminishing value rate from 150 per cent to 200 per cent for depreciating assets will allow businesses to write off the cost of new plant and equipment more rapidly for tax purposes, reducing the cost of investing in eligible assets over their effective lives (see Box 3). This will directly reduce the cost of investment, particularly for start-ups and new enterprises in the crucial early phase of a business venture.

The measure is equivalent to a 33 per cent increase in the allowable depreciation rate for all eligible assets. For example, for an asset with a ten-year effective life, the annual rate of depreciation will increase from the current rate of 15 per cent to 20 per cent.

Box 3: How the increased diminishing value rate will benefit business

The following examples illustrate how the increase in the diminishing value rate will affect the depreciation deductions that a business can claim. The increase in the diminishing value rate increases the deductions available to a business early in the asset's effective life, when assets typically decline most in value.

As shown in the examples below, the increase in the diminishing value factor does not change the effective life over which the assets are depreciated or the total dollar amount written off over the asset's effective life (assuming assets are scrapped at the end). However, the depreciation deductions in the early part of the asset's effective life are higher, increasing their net present value and reducing a business's financial cost of holding the asset.

Table 3: Depreciation on a new $4,000 computer — effective life of 4 years

	Current arrangements		New arrangements	
Year asset held	Written down value as percentage of purchase price at end of period	Depreciation deduction $	Written down value as percentage of purchase price at end of period	Depreciation deduction $
1	63	1,500	50	2,000
2	39	938	25	1,000
3	24	586	13	500
4	0	977	0	500

Table 4: Depreciation on a new $20,000 forklift — effective life of 11 years

	Current arrangements		New arrangements	
Year asset held	Written down value as percentage of purchase price at end of period	Depreciation deduction $	Written down value as percentage of purchase price at end of period	Depreciation deduction $
1	86	2,727	82	3,636
2	75	2,355	67	2,975
3	64	2,034	55	2,434
4	56	1,757	45	1,992
5	48	1,517	37	1,630
6	41	1,310	30	1,333
7	36	1,132	25	1,091
8	31	977	20	893
9	27	844	16	730
10	23	729	13	597
11	0	4,617	0	2,689

Improving resource allocation

Taxation is only one of a number of factors that are taken into account when making investment decisions. However, the favourability or otherwise of the tax treatment of an investment can have a significant impact on investment decisions.

The diminishing value method is intended to approximate the actual decline in value of an asset and the true cost to taxpayers of the asset as an input cost. Where depreciation deductions are less than this actual cost, taxpayers may hold assets longer than necessary to maximise the tax benefit from their investment. As a consequence, the rate of change of the increase in capital stock will be lower than it would otherwise be without the tax-induced distortion. This has a negative impact on productivity and economic growth.

Where possible, all forms of investment should be taxed neutrally so that the tax system does not divert investment away from the most productive assets. If the tax system biases investment decisions, this will lead to an inefficient allocation of resources and impede productivity and economic growth.

Ensuring, as far as possible, that depreciation for tax purposes aligns with the way assets actually decline in value ensures the tax system is neutral with respect to investment incentives.

The measure will provide a substantial benefit to both individuals and businesses. It will encourage additional and more efficient investment in all eligible plant and equipment, which will strengthen prospects for economic and employment growth through capital deepening and improved resource allocation.

Application

The 200 per cent diminishing value rate will apply to eligible assets (new and second hand) acquired on or after 10 May 2006, including assets with statutory caps. It will also apply to project pool expenditure for new projects.

The simplified depreciation arrangements for small businesses under the STS, low-value pools and special arrangements for horticultural plants will not be changed.

REDUCING COMPLEXITY FOR SMALL BUSINESS

The Government will introduce a number of reforms to simplify the tax system for small business. These reforms will reduce taxes on small business by $435 million over four years and deliver $40 million worth of changes to simplify fringe benefits tax. These measures reduce compliance costs for small business and allow more taxpayers to be eligible for the small business tax arrangements.

In recognition of the potentially significant economic and social costs of complexity, the Government established the Taskforce on Reducing Regulatory Burdens on Business (the Taskforce) in October 2005.

In April 2006, the Government issued an interim response to some of the Taskforce's recommendations, including reforms to fringe benefits tax, that the Taskforce had identified as a priority for reducing tax complexity for business. This budget builds on those announcements, with a range of measures directed at further reducing the complexity faced by small business. In aggregate, the simplification measures included in this budget:

- address concerns about the complexity associated with the range of small business definitions in the tax law by:
  - aligning a range of small business measures set at turnover levels of between $1 million and $2 million;
  - aligning certain methodologies by which turnover is calculated under the STS and goods and services tax;
  - increasing the STS annual turnover threshold from $1 million to $2 million;
  - removing the $3 million depreciating assets test from the STS eligibility requirements altogether; and
  - increasing the net assets threshold for the capital gains tax (CGT) small business concessions from $5 million to $6 million;
- allow STS taxpayers to be eligible for the CGT small business concessions without having to satisfy the net assets threshold and to pay quarterly pay as you go instalments on the basis of GDP-adjusted notional tax;
- introduce a number of measures that will simplify and extend small business access to CGT concessions in response to the Board of Taxation's post implementation review of small business CGT arrangements;
  - In addition to responding to the Board of Taxation's review, the measure also improves access to the small business capital gains tax concessions for the owners of small businesses by replacing the current 50 per cent controlling individual test with a 20 per cent significant individual test.
- extend depreciating asset roll-over relief under the uniform capital allowance regime to situations where a sole trader, trustee or partnership in the STS disposes of all the assets in an STS pool to a wholly-owned company;

- increase the fringe benefits tax reporting and minor benefits thresholds in response to the report of the Taskforce; and
- increase the in-house fringe benefits tax-free threshold from $500 to $1,000.

ENCOURAGING INVESTMENT IN VENTURE CAPITAL

The Government will introduce a suite of new measures to encourage venture capital investment. The Government will introduce an early stage venture capital limited partnership investment vehicle to provide investors with flow-through tax treatment and a complete tax exemption on capital and revenue gains. The existing venture capital limited partnership vehicle will be enhanced by easing a number of restrictions.

The Government will also provide $200 million to support a third round of the Innovation Investment Fund programme. This will increase the number of fund managers with expertise in the venture capital sector and provide more start-up capital to new companies, particularly those with a technology focus.

MAINTAINING THE INTEGRITY OF THE TAX SYSTEM

This budget continues to build on the Government's achievements in maintaining the integrity of the tax system and paves the way for a simpler and fairer tax system for all Australians. The tax integrity measures announced in this budget work to maintain an equitable tax base and are estimated to save $2.3 billion in revenue over the forward estimates period. Substantial funds of over $350 million are being provided to 'Operation Wickenby' to address tax fraud and to the Australian Taxation Office (ATO) to maintain its tax compliance programme for high wealth individuals.

HIGH WEALTH INDIVIDUALS AND ASSOCIATED ENTITIES

The Government will provide the ATO with additional resources to allow it to maintain its tax compliance programme for high wealth individuals and their associated entities.

The additional funding will allow the ATO's High Wealth Individual Taskforce to cover the increase in the number of high wealth individuals in recent years. The additional funding will enable the ATO to improve its identification of compliance risks and to undertake additional audit activity for all identified high-risk cases, including closely-held private company groups.

The measure will ensure that high wealth individuals are appropriately taxed and is expected to raise $615 million over the forward estimates period.

TRUST DISTRIBUTIONS TO NON-RESIDENT TRUSTEES

The Government will protect the integrity of the tax system by ensuring that an appropriate amount of tax is paid on income distributed by Australian resident trustees to non-resident trustee beneficiaries.

It is important that income that should be taxed is able to be taxed. This ensures our income tax base can be sustained and community confidence in the fairness and equity of our tax laws is maintained.

Under the current law a resident trustee is liable to pay tax on distributions to non-resident individuals and companies. This effectively ensures that Australia receives its share of tax on funds before they flow offshore. However, trust distributions to non-resident trustee beneficiaries are not taxed in this way. This makes enforcing compliance of non-resident tax obligations extremely difficult, resulting in significant revenue leakage.

This measure is expected to raise $800 million over the forward estimates period and will ensure that trust distributions to non-resident trustee beneficiaries are appropriately taxed; that is, in a manner consistent with individual and company beneficiaries.

SUPERANNUATION — ENSURING APPROPRIATE USE OF PRE-1 JULY 1988 FUNDING CREDITS

In the context of an ageing population, and the considerable taxation concessions provided to superannuation, it is important that the integrity of the superannuation taxation system and revenue base is maintained.

Currently, some public sector superannuation schemes are able to reduce the tax payable on contributions (to the benefit of scheme employers who are able to reduce the level of contributions they make) by inappropriately applying pre-1 July 1988 funding credits to remove tax on contributions that should otherwise be taxable.

In particular, they use funding credits to remove tax on contributions made to fund benefits that accrued after 1 July 1988. Such credits should only be used to remove tax on contributions paid to fund benefits that accrued before 1 July 1988 (when the 15 per cent tax on contributions was introduced). The Government will amend the law to ensure that this is the case, so that funding credits cannot be used inappropriately to the detriment of Australian Government revenue and thus all taxpayers. Ending the inappropriate use of funding credits is expected to save Australian taxpayers $600 million over four years.

SIMPLIFYING THE ULTIMATE BENEFICIARY RULES FOR TRUSTS

The Government will simplify the reporting requirements under the ultimate beneficiary rules by requiring that trustees of closely-held trusts need identify and report only first-tier beneficiaries in receipt of trust distributions. This change will allow the ATO to use the better targeted information provided by trustees and data matching to trace trust distributions to beneficiaries and be more effective in attributing trust distributions to beneficiaries.

The measure will provide significant compliance cost savings while maintaining the integrity of the taxation of trust income.

ADDRESSING OFFSHORE TAX SCHEMES

The measures announced in the budget build upon the Government's well-established commitment to protecting the integrity of the tax system.

Under Operation Wickenby, the ATO, the Australian Crime Commission, the Australian Federal Police, the Australian Securities and Investments Commission and the Commonwealth Director of Public Prosecutions have been working closely together over the past nine months to address alleged tax fraud involving the use of offshore entities. The arrangements are alleged to involve falsification of tax deductions or hiding and not declaring income.

This budget includes the commitment of an additional $305 million over seven years for investigations and prosecutions related to Operation Wickenby. This measure is also expected to result in increased tax revenue of $323 million over four years from active compliance activity and through improved compliance behaviour by the relevant taxpayers.

Appendix A: The Australian Government's record on tax reform

This appendix provides a short overview of the major tax reforms undertaken by the Government between 1996 and the 2006-07 Budget.

Personal income tax reforms

The Government's commitment to structural personal income tax reform has been ongoing since *The New Tax System* was introduced on 1 July 2000. As part of this tax reform, the Government enhanced incentives to work by ensuring that 80 per cent of taxpayers face a top marginal rate of 30 per cent or less. This compares with only 30 per cent of taxpayers facing a top marginal rate of 30 per cent or less prior to the introduction of *The New Tax System*. Workers on the average full-time wage prior to the 2000-01 tax cuts faced a 43 per cent marginal rate, and rates of 34 to 46 per cent over the 16 years from 1984-85. Workers on the average full-time wage today (around $53,000) have a top marginal tax rate of 30 per cent.

The family benefit system was dramatically improved and simplified. Government pensions and allowances were increased. And the changes were made in the context of a shift from an inefficient wholesale sales tax and inefficient state transaction taxes (such as stamp duty on shares, the bed tax and Financial Institutions Duty) to a more broadly based and efficient indirect tax base.

In addition, *The New Tax System* involved the largest personal income tax cuts in Australia's history with cuts of $12 billion per annum. Building on these reductions, the 2003-04 Budget introduced personal income tax cuts of $10.7 billion over four years, the 2004-05 Budget introduced further cuts of $14.7 billion over four years, and the tax cuts announced in the 2005-06 Budget were worth a further $21.7 billion over four years.

The Government has also reduced significantly the number of taxpayers facing the top marginal personal tax rate. The Government has increased the highest marginal tax threshold from $50,001 — before *The New Tax System* — to $150,001 effective from 1 July 2006 (as announced in the 2006-07 Budget). In contrast, if the threshold for the top marginal rate had merely been indexed to inflation since 1996, on 1 July 2006 it would have been less than $66,000.

The Government has also demonstrated an unprecedented commitment to families. Building on a range of increases in family assistance since 1996, the $19.2 billion *More Help for Families* package was introduced in the 2004-05 Budget. The Government continued to demonstrate support for families in the 2005-06 Budget, expanding support for child care and increasing Family Tax Benefit for many households. In addition, the new Child Care Tax Rebate will assist families with their out-of-pocket child care expenses.

BUSINESS TAX REFORMS

The Government's *New Business Tax System*, introduced in 1999 and flowing from the Review of Business Taxation, has created an environment for achieving higher economic growth and a sustainable revenue base through an efficient, competitive and fair business tax regime.

The Government cut the company tax rate from 36 per cent to 30 per cent over two years from 2000-01. This has made the headline rate of corporate tax internationally competitive both in the Asia-Pacific region and relative to the major sources of investment into Australia from OECD countries.

The Government introduced the consolidation regime to enable wholly-owned groups to be treated as a single entity with effect from 1 July 2002. Consolidation improves efficiency by providing a business environment in which highly complex business structures are no longer necessary.

Other reforms have reduced the tax compliance burden on small business and extended advantageous tax arrangements to these taxpayers. The Simplified Tax System provides a simplified depreciation scheme including immediate write off for assets costing less than $1,000 and 30 per cent depreciation for pooled assets with an effective life of less than 25 years. This reduces paperwork and reporting requirements and also reduces the tax burden.

The Government has also reformed capital gains tax (CGT). For example it has introduced the 50 per cent CGT discount, introduced (and later significantly expanded) additional special CGT treatments for small business, and introduced the scrip-for-scrip rollover. The small business arrangements significantly reduce (and in many cases eliminate) the CGT that small business owners pay.

Other significant reforms include establishing the Australian Business Number (ABN) to make it more difficult for those operating in the cash economy to avoid their proper share of taxation, allowing excess imputation credits to be refunded (important for low-income earners and retirees) and introducing uniform capital allowances, tax relief for demergers, the simplified imputation system and the entrepreneur's tax offset. The Government continues to look for improvements to the tax system with measures such as the systematic treatment of business 'blackhole' expenditures and advancing work on the taxation of financial arrangements.

These foundation reforms, and the consultation with business taxpayers that informed their development, have set a framework enabling the Government to continue to focus on a business tax system that promotes efficiency and competitiveness, while making things simpler and fairer for business taxpayers.

INDIRECT TAX REFORMS

One of the greatest challenges facing the Government when it came to office was the inefficient, complex and unsustainable wholesale sales tax. Multiple rate structures, a narrow and declining base, and the input taxation of our exports, were part of the legacy faced by the Government. In addition, there was a very sizeable gap between the revenues raised by the States and their expenditure responsibilities (vertical fiscal imbalance).

The goods and services tax (GST) has provided the States and Territories with a secure, growing and broad-based revenue source, raising approximately $35 billion in 2004-05. It has replaced inefficient taxes such as the wholesale sales tax and a number of state taxes, including Financial Institutions Duty and the Bank Account Debits tax. It has provided a more efficient indirect tax system suited to Australia's role in an increasingly globalised world.

Such major reform exercises inevitably involve transitional costs. The Government introduced measures to make lodging and accounting for GST easier. Businesses with an annual turnover less than $1 million may account for GST on a cash basis and those with an annual turnover under $20 million have the option of lodging their GST returns monthly or quarterly. Voluntary GST registrants need only pay GST once a year.

As part of the transition to *The New Tax System*, the Government cut fuel excise by 6.7 cents per litre (cpl) in July 2000. In March 2001, fuel excise was cut again by 1.5 cpl to 38.1 cpl. The Government also abolished the indexation of fuel excise (six-monthly inflation adjustment). The rate of 38.1 cpl has remained constant since March 2001. Without these changes, the current excise rate would be over 15 cpl higher at around 53.6 cpl.

As part of *The New Tax System*, the Government also introduced a special grant scheme for heavy road transport. As a result of these changes, the effective tax paid on diesel by heavy transport operators was reduced from 44.1 cpl (at 30 June 2000) to 19.6 cpl (after input tax credits).

The Government is implementing a major programme of reform to modernise and simplify the fuel tax system. The reforms also greatly extend the range of fuels and fuel uses that qualify for a credit, effectively reducing fuel tax collections from businesses and households by $1.5 billion over the period to 2012-13. Over time all off-road business use of fuel will become effectively free of fuel tax, while business use of fuel on-road in heavy vehicles will only incur a road user charge.

INTERNATIONAL TAX REFORMS

The Government's Review of International Tax Arrangements (RITA) emanated from concerns that Australia's international tax arrangements were outdated and needed to be changed in order for Australia to remain a competitive location and an attractive place for business and investment. Australia's tax system needed reform so it was compatible with the requirements of an integrated global business environment.

The Government announced in the 2003-04 Budget over 30 individual initiatives designed around the principle that Australia's tax system should not impede those Australian businesses seeking to operate in a globalising environment, nor should it place barriers in front of those internationally focused businesses seeking to use Australia as a base for their regional headquarters.

The Government's international tax reforms are ongoing, with further actions in the 2005-06 Budget to enhance the international competitiveness of Australia's tax system. These reforms increase the attractiveness of Australia as a destination for foreign capital, which in turn allows higher rates of economic growth and employment levels, and higher standards of living for Australians.

Efforts to modernise our treaty network are also part of the process of ensuring that Australia remains competitive in today's environment. The protocol amending the United States tax treaty, which was signed on 27 September 2001, included the reduction in a range of withholding taxes on investments. The protocol is a major step in facilitating a competitive and modern treaty network for companies located in Australia and will significantly assist trade and investment flows between the two countries.

TAX ADMINISTRATION REFORMS

In addition to the range of policy reforms introduced by this Government, there have been significant supporting changes to the administrative elements of the tax system. Effective implementation of an active tax reform agenda requires a world-class system for tax design, and good consultative links with the broader community.

The Board of Taxation was set up in 2000 as an independent, non-statutory body to advise the Government on the tax system by contributing a business and broader community perspective to improving the design of taxation laws and their operation. In 2001, the Government established a dedicated Minister for Revenue to deal with the range of challenges from the ongoing tax reform programme. In 2003, the Government appointed an Inspector-General of Taxation with the role of identifying opportunities for improvement in tax administration.

Another Government strategy to improve the tax design process is strengthened consultation. In May 2002, the Government made an in-principle commitment to enhanced community consultation on substantive announced tax measures.

The Review of Aspects of Income Tax Self Assessment (ROSA) examined aspects of Australia's self assessment system for income tax to determine whether the right balance had been struck between protecting the rights of individual taxpayers and protecting the revenue for the benefit of the whole community.

The Government is implementing all of the review's recommendations, which will reduce complexity and compliance costs for all taxpayer groups and their advisers. Taxpayers will have improved certainty through a better framework for taxpayer advice, and reduced amendment periods for some eight million individual taxpayers and over 745,000 Simplified Tax System businesses. Interest and penalty consequences of taxpayer errors arising from uncertainties in the self assessment system have also been mitigated.

In addition, the Government has prepared draft legislation containing proposals to repeal more than 4,100 pages of inoperative provisions from Australia's tax legislation. The draft legislation proposes to reduce the income tax law by almost one-third. The *Income Tax Assessment Act 1936* will be reduced to half its current size.

Repealing the inoperative provisions is a significant step to reduce complexity in our tax laws. Tax practitioners will find it much easier to navigate the printed and electronic versions of the income tax law.

APPENDIX B: TAX REFORM MEASURES IN THE 2006-07 BUDGET[1]

Continuing personal tax reform

Personal income tax cuts

Fringe benefits tax — reduction in rate

Family Tax Benefit — increase Family Tax Benefit Part A income threshold

Family Tax Benefit — extending the large family supplement

Electronic data provision for e-tax returns

Personal income tax — remove the part-year tax-free threshold for students ceasing full-time education for the first time

Employee share schemes — extending current concessions to stapled securities

Continuing business tax reform

Uniform capital allowance — diminishing value rate

Small business — aligning definitions in the tax laws

Small business — capital gains tax amendments

Simplified tax system — extending depreciating asset roll-over relief

Fringe benefits tax — increasing the reportable fringe benefits exclusion threshold

Fringe benefits tax — increasing the minor benefits exemption threshold

Fringe benefits tax — increasing the in-house fringe benefits tax-free threshold

Venture capital — improving taxation treatment

Maintaining the integrity of the tax system

Tax compliance — high wealth individuals and associated entities

Taxation of trusts — distributions to non-resident trustees

Superannuation — ensuring appropriate use of pre-1 July 1988 funding credits

Taxation of trusts — simplifying the ultimate beneficiary rules

Operation Wickenby — addressing offshore tax schemes

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1 This appendix contains an excerpt from the complete list of measures announced in the Budget, as provided in Budget Paper No. 2, *Budget Measures 2006-07*.

Technical notes on tables

(a) A minus sign against a revenue measure indicates a reduction in the fiscal balance.

(b) A minus sign against an expense measure indicates an increase in the fiscal balance.

(c) Figures in tables and generally in the text have been rounded. Discrepancies in tables between totals and sums of components are due to rounding.

(d) The following notations are used:

*	The nature of this measure is such that a reliable estimate cannot be provided.
-	Nil
$m	$ million

CONTINUING PERSONAL TAX REFORM

Personal income tax cuts

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-6,385.0	-9,205.0	-9,830.0	-10,435.0

The Government will provide tax cuts worth $36.7 billion (including the reduction in the fringe benefits tax rate) over four years. This is in addition to the $21.7 billion worth of tax cuts announced in last year's budget.

Changes to the personal tax rates and thresholds from 1 July 2006 are as follows:

- the 30 per cent threshold will rise from $21,601 to $25,001;
- the 42 per cent marginal tax rate will be cut to 40 per cent and the threshold will rise from $63,001 to $75,001; and
- the top marginal tax rate will be cut from 47 per cent to 45 per cent and the threshold will rise from $95,001 to $150,001.

In addition, the Low Income Tax Offset will increase from $235 to $600 and will begin to phase-out from $25,000. The Medicare levy phase-in for low-income earners will also be reduced from 20 per cent to 10 per cent.

Current tax thresholds Income range ($)	Tax rate %	New tax thresholds from 1 July 2006 Income range ($)	Tax rate %
0 - 6,000	0	0 - 6,000	0
6,001 - 21,600	15	6,001 - **25,000**	15
21,601 - 63,000	30	**25,001 - 75,000**	30
63,001 - 95,000	42	**75,001 - 150,000**	**40**
95,001 +	47	**150,001 +**	**45**

The tax cuts will increase disposable incomes for all Australian taxpayers, provide further incentives to participate in the workforce and improve the international competitiveness of Australia.

Over 80 per cent of taxpayers will face a top marginal tax rate of no more than 30 per cent over the forward estimates period with taxpayers needing to earn $121,500 to pay an average tax rate of 30 per cent.

Reducing the top marginal tax rate and significantly increasing the top threshold will improve our competitiveness compared with other OECD countries. In 2006-07, the top marginal tax rate will apply to around 2 per cent of taxpayers.

Low Income Tax Offset

To assist low income earners, from 1 July 2006 the Low Income Tax Offset will increase from $235 to $600 per year. In addition, the income threshold at which the offset begins to reduce will increase from $21,600 to $25,000. As a result of both of these changes, the income limit up to which some offset can be claimed will increase from $27,475 to $40,000. Taxpayers with annual incomes between $21,600 and $40,000 will benefit from both the increase in the 30 per cent threshold to $25,001 and the increase in the Low Income Tax Offset.

Those eligible for the full Low Income Tax Offset will not pay tax until their annual income exceeds $10,000 (up from $7,567 currently).

Senior Australians

Senior Australians eligible for the Senior Australians Tax Offset currently pay no tax up to an annual income of $21,968 for singles and $36,494 for couples (depending on the income earned by each member of the couple). The effect of the tax cuts is to lift these income levels up to $24,867 for singles and $41,360 for couples.

The Medicare levy threshold that applies to senior Australians will be increased to ensure that senior Australians do not pay the Medicare levy until they begin to incur an income tax liability.

Consequential changes

The top marginal tax rate is the rate applicable in a number of cases in different parts of the tax law. For example, it is applied to contributions and earnings of non-complying superannuation funds, the unearned income of minors and the net income of a trust estate to which no beneficiary is presently entitled. Generally, rates of tax that reflect the top marginal rate will also be reduced to 45 per cent.

See also the following related revenue measure *Fringe Benefits Tax — reduction in rate*.

Fringe benefits tax — reduction in rate

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-260.0	-195.0	-205.0	-210.0

The Government will reduce the fringe benefits tax (FBT) rate from 48.5 per cent to 46.5 per cent, with effect from 1 April 2006.

This change will ensure that the FBT rate aligns with the top personal income tax rate (including the Medicare levy).

For further details on the personal income tax package see the related revenue measure *Personal income tax cuts* in Budget Paper No. 2 under the Treasury portfolio.

Family Tax Benefit — increase Family Tax Benefit Part A income threshold

Expense ($m)

	2006-07	2007-08	2008-09	2009-10
Department of Families, Community Services and Indigenous Affairs	200.3	203.0	204.2	209.2
Australian Taxation Office	22.3	22.6	22.7	23.2
Department of Health and Ageing	19.2	20.6	22.1	23.9
Total	241.8	246.2	249.0	256.3

The Government will relax the income test for Family Tax Benefit Part A (FTB (A)) at a cost of $993.3 million over four years. From 1 July 2006, the amount that a family can earn each year before their FTB (A) is reduced will be increased to $40,000.

This measure will extend the planned increase in the FTB (A) maximum rate threshold announced in the 2005-06 Budget by a further $2,500 (from $37,500). Once the income of families with dependent children exceeds the maximum threshold, FTB (A) reduces from the maximum rate at a rate of 20 cents for every extra dollar of income, until the base rate of payment is reached.

Funding for the measure includes $90.8 million over four years for those who receive FTB (A) payments though the ATO, and $85.8 million over four years for the Department of Health and Ageing to cover flow-on costs from increased eligibility for Health Care concession cards.

It is expected that this measure will increase the amount of FTB (A) received by over 480,000 families.

Family Tax Benefit — extending the large family supplement

Expense ($m)

	2006-07	2007-08	2008-09	2009-10
Department of Families, Community Services and Indigenous Affairs	102.3	112.9	115.4	116.5
Australian Taxation Office	11.4	12.5	12.8	12.9
Total	113.7	125.4	128.2	129.4

The Government will extend the Large Family Supplement to families with three children entitled to Family Tax Benefit Part A (FTB (A)), at a cost of $496.7 million over four years from 1 July 2006.

Currently the supplement is paid to families with four or more children entitled to FTB (A) and approximately 100,000 families receive the large family supplement. It is expected that this measure will increase the number of families receiving the supplement to approximately 440,000.

Electronic data provision for e-tax returns

Expense ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	5.0	5.0	-	-

The Government will provide the Australian Taxation Office (ATO) with additional resources of $10 million over two years to enable it to accelerate its programme of providing taxpayer data electronically in e-tax returns. This measure will fund trials in 2007-08 and 2008-09 to allow taxpayers to download dividend distributions from share registers directly into their e-tax returns.

The trial in 2007-08 will be available to individual taxpayers using e-tax. If successful, the ATO will extend the trial in 2008-09 to tax agents using the tax agent portal.

Providing taxpayers with the ability to download tax information directly into their e-tax returns makes preparing a tax return simpler and easier by removing the need for taxpayers to enter this data manually.

Personal income tax — remove the part-year tax-free threshold for students ceasing full-time education for the first time

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-2.0	-2.0	-2.0

The Government will remove the part-year tax-free threshold for taxpayers ceasing full-time education, with effect from the 2006-07 income year.

Currently, taxpayers who cease full-time education for the first time are not eligible for the full tax-free threshold of $6,000. For the year in which a taxpayer first ceases full-time education, the reduced tax-free threshold is calculated by multiplying the number of months in the income year that the taxpayer was not studying full-time by the monthly equivalent of the tax-free threshold ($500). If a taxpayer derives income during the income year in which the taxpayer was a full-time student, the reduced threshold is increased by the amount of income derived up to the standard tax-free threshold for the year.

This measure will extend the full tax-free threshold of $6,000 to all resident taxpayers that cease full-time education for the first time. This will reduce compliance costs for taxpayers who have finished full-time education for the first time by removing the requirement for these taxpayers to calculate a part-year tax-free threshold and will end the requirement for taxpayers to isolate income (and any deductions) attributable to the period during which a taxpayer was engaged in full-time study.

Employee share schemes — extending current concessions to stapled securities

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-10.0	-20.0	-20.0	-20.0

The Government will extend the employee share scheme and related capital gains tax provisions to stapled securities that include an ordinary share and are listed on the Australian Stock Exchange, with effect from 1 July 2006.

Currently, employees participating in an employee share scheme can choose the tax-deferred or the tax-upfront concession on any discount they receive from acquiring shares or rights below their market value, subject to certain conditions. One condition is that shares must be ordinary shares, and that rights must be rights to acquire ordinary shares.

Currently, these concessions do not fully apply to stapled securities that are created when an ordinary share and another security, such as a unit in a unit trust, are contractually bound together so that they cannot be sold separately.

This measure will increase the accessibility of employee share schemes to employers with stapled securities, and decrease the complexity and cost associated with providing certain stapled securities to their employees.

CONTINUING BUSINESS TAX REFORM

Uniform capital allowance — diminishing value rate

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-500.0	-900.0	-1,100.0	-1,200.0

The Government will increase the diminishing value rate for determining depreciation deductions from 150 per cent to 200 per cent for all eligible assets aquired on or after 10 May 2006.

The measure will more accurately align depreciation deductions for tax purposes with the actual decline in the economic value of assets. It will increase the incentives for Australian business to undertake the investment in new plant and equipment that is necessary for them to keep pace with new technology and to remain competitive.

In 2001, the Government introduced the uniform capital allowance (UCA) regime which calculates depreciation deductions based on the expected effective life of a depreciating asset. This measure will enhance the operation of the UCA regime.

Currently, a taxpayer can use either the diminishing value or the prime cost (straight-line) method for depreciating assets. The diminishing value method uses a fixed proportion (determined by the diminishing value rate and the effective life) of the asset's written down value to establish its annual decline in value. This reflects that the asset's value declines more rapidly in the initial years in which the asset is held. Under the prime cost method, the asset is written off in equal instalments over the asset's effective life. Generally, a taxpayer can choose between the two methods.

The current 150 per cent diminishing value rate does not fully reflect the true change in value of many depreciating assets. This results in depreciation rates that are generally too low for most plant and equipment. By increasing the diminishing value rate to 200 per cent, this measure will ensure that tax depreciation rates more closely align with economic depreciation.

Small business — aligning definitions in the tax laws

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-1.0	-55.0	-71.0

The Government will simplify and improve alignment of various small business tax relief arrangements contained in the tax laws, including the simplified tax system (STS), capital gains tax (CGT), goods and services tax, fringe benefits tax and pay as you go (PAYG) instalments. This measure will apply from the start of the 2007-08 income year.

This measure will:

- increase the STS annual turnover threshold from $1 million to $2 million;
- remove the $3 million depreciating assets test from the STS eligibility requirements;
- increase the net assets threshold for the CGT small business concessions from $5 million to $6 million; and
- allow STS taxpayers to be eligible for the CGT small business concessions without having to satisfy the net assets threshold and to pay quarterly PAYG instalments on the basis of GDP-adjusted notional tax.

See also the related item *Small business — aligning definitions in the tax laws* in Appendix A of Budget Paper No. 3.

Small business — capital gains tax amendments

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-92.0	-97.0	-101.0

The Government will implement all but one of the recommendations of the Board of Taxation's post-implementation review of the small business capital gains tax (CGT) concessions.

The amendments will ensure that the concessions are simpler, clearer and fairer. They will also reduce compliance costs for small business.

The Government will improve the operation of the small business CGT concessions by making changes to the maximum net asset value test, the active asset test, the 15-year exemption, the retirement exemption, the small business roll-over, and how the concessions apply to partnerships.

In addition to these amendments, the Government will provide improved access to the concessions by replacing the current 50 per cent controlling individual test with a more generous 20 per cent significant individual test. The significant individual test will be able to be satisfied either directly or indirectly through one or more interposed entities.

These measures will apply to CGT events that happen in the 2006-07 and later income years.

Simplified tax system — extending depreciating asset roll-over relief

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-6.0	-7.0	-5.0

The Government will extend optional roll-over relief available under the uniform capital allowance (UCA) regime to situations where a sole trader, trustee or a partnership in the simplified tax system (STS) disposes of all of the assets in an STS pool to a wholly-owned company, and to where an STS pool is transferred as a result of a court order upon a marriage breakdown. The measure will have effect from the income year following the date of Royal Assent of the enabling legislation.

Providing roll-over relief in these situations will provide more flexibility for STS taxpayers wishing to restructure their business and ensure that roll-over relief available under the UCA regime is also available in relation to STS depreciating asset pools.

Fringe benefits tax — increasing the reportable fringe benefits exclusion threshold

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-	-2.1	-2.1
Related expense ($m)				
Australian Taxation Office	-	..	..	..

The Government will increase the reportable fringe benefits exclusion threshold from $1,000 to $2,000, with effect from 1 April 2007.

Increasing the reportable fringe benefits exclusion threshold from $1,000 to $2,000 will enable employers to reduce their compliance and record-keeping costs by not having to report fringe benefits for employees who receive no more than $2,000 worth of grossed-up fringe benefits in the fringe benefits tax year.

Further information can be found in the joint press release of 7 April 2006 issued by the Prime Minister and the Treasurer.

Fringe benefits tax — increasing the minor benefits exemption threshold

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-3.0	-1.0	-2.0

The Government will increase the minor benefits exemption threshold from $100 to $300, with effect from 1 April 2007.

The minor benefits exemption is provided to ensure that small and infrequently provided benefits to employees are not subject to fringe benefits tax (FBT). Increasing the minor benefits exemption threshold will increase the value of benefits that are exempt from FBT to include all benefits valued at less than $300 and will reduce compliance and record-keeping costs for employers who infrequently provide benefits that do not exceed $300.

Further information can be found in the joint press release of 7 April 2006 issued by the Prime Minister and the Treasurer.

Fringe benefits tax — increasing the in-house fringe benefits tax-free threshold

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-10.0	-10.0	-10.0

The Government will increase the in-house fringe benefits tax-free threshold from $500 to $1,000, with effect from 1 April 2007.

An in-house fringe benefit is a good or service provided to an employee that is identical or similar to those that the employer supplies to the public in the ordinary course of the employer's business.

This measure will result in employers not paying fringe benefits tax on the value of in-house fringe benefits provided to employees that do not exceed the new $1,000 threshold.

Venture capital — improving taxation treatment

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	-1.0	-4.0	-10.0
Related expense ($m)				
Department of Industry, Tourism and Resources	*0.3*	*0.3*	*0.3*	*0.3*

The Government will introduce a new investment vehicle called an early stage venture capital limited partnership (ESVCLP) which will, from 1 July 2006, progressively replace the existing pooled development funds (PDFs) arrangements. The Government will also make changes to the existing venture capital limited partnership (VCLP) regime.

The ESVCLP will provide flow-through tax treatment to domestic and foreign partners with the income, both revenue and capital, received by the partners being exempt from taxation. As the income will be exempt from tax, the investor will not be able to deduct investment losses.

To qualify for the tax exemption: the ESVCLP fund size cannot exceed $100 million; an individual investment in any one company cannot exceed 30 per cent of the ESVCLP fund's committed capital; the total assets of the investee company cannot exceed

$50 million prior to the investment; the ESVCLP must divest its assets in the investee company once the total assets of the investee company exceed $250 million; and the ESVCLP must meet certain regulatory and reporting requirements. The existing PDF programme will be closed to new registrations after 31 December 2006.

The existing VCLP regime will be enhanced by: removing restrictions on the country of residence of investors; reducing the minimum partnership capital required for registration to $10 million; allowing investment in unit trust and convertible notes as well as shares; allowing appointment of auditors for investee companies to occur at the end of the financial year of the investment; and relaxing the requirement that 50 per cent of assets and employees must be in Australia for 12 months after the making of the investment.

The Government will provide $0.3 million per annum on an ongoing basis from 2006-07 to the Department of Industry, Tourism and Resources to implement and administer the new arrangements.

See also the related expense measure *Venture capital — Innovation Investment Fund — new funding round* in the Industry, Tourism and Resources portfolio.

MAINTAINING THE INTEGRITY OF THE TAX SYSTEM

Tax compliance — high wealth individuals and associated entities

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	65.0	145.0	190.0	215.0
Related expense ($m)				
Australian Taxation Office	*12.7*	*18.3*	*23.6*	*27.0*

The Government will provide the Australian Taxation Office (ATO) with additional resources to maintain tax compliance by high wealth individuals and their associated entities.

This measure will allow the ATO's High Wealth Individual Taskforce to cover the increase in the number of high wealth individuals in recent years. The additional resources will enable the ATO to improve the timely identification of tax compliance risks for the increased number of high wealth individuals and to undertake additional audit activity for all identified high-risk cases, including closely-held private company groups.

Since its inception in 1997, the Taskforce has collected over $1.3 billion in additional revenue from audits of high wealth individuals. Indications are that this activity has also improved voluntary compliance by this sector.

Taxation of trusts — distributions to non-resident trustees

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	-	250.0	270.0	280.0

The Government will enhance the integrity of the tax system by requiring resident trustees to pay tax on distributions to non-resident trustee beneficiaries. This measure will have effect from 1 July 2006.

Currently, a resident trustee is liable to pay tax on distributions to non-resident individuals and companies. In these cases, the non-resident is also assessed on the distribution with a credit for tax already paid by the resident trustee. These arrangements currently do not apply to distributions to non-resident trustees.

This measure will ensure that trust distributions to non-resident trustees are taxed in the same way as distributions to other non-resident beneficiaries.

Superannuation — ensuring appropriate use of pre-1 July 1988 funding credits

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	150.0	150.0	150.0	150.0

The Government will ensure that pre-1 July 1988 funding credits can be used by superannuation schemes only in circumstances consistent with the original policy intent. Pre-1 July 1988 funding credits will be able to be used by superannuation schemes to reduce their taxation liability on contributions made after 1 July 1988 only if those contributions were made to fund benefits that accrued before 1 July 1988. This measure will take effect from 9 May 2006.

Since 1 July 1988 most contributions to superannuation schemes have been subject to a 15 per cent tax. Unfunded superannuation schemes have access to pre-1 July 1988 funding credits so that contributions made after 1 July 1988 in order to fund benefits that accrued prior to 1 July 1988 are not taxed. This ensures equity with funded superannuation schemes that pay tax on contributions from 1 July 1988.

The Government has become aware of arrangements under which some public sector superannuation schemes are inappropriately applying pre-1 July 1988 funding credits to reduce tax on contributions made to fund benefits that accrued after 1 July 1988. This measure will remove this anomaly and ensure consistent treatment between funded and unfunded schemes.

Taxation of trusts — simplifying the ultimate beneficiary rules

Revenue ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	*	*	*	*

The Government will simplify the reporting requirements under the ultimate beneficiary rules by requiring that trustees of closely-held trusts need identify and report only first-tier trustee beneficiaries in receipt of trust distributions. This measure will have effect from the taxpayer's first income year after the enabling legislation receives Royal Assent.

Currently, the ultimate beneficiary rules require trustees of closely-held trusts to trace through chains of trusts to identify the ultimate beneficiaries of distributions from the trust.

Under this measure, the Australian Taxation Office will be able to use the better targeted information provided by trustees and data matching to trace trust distributions to beneficiaries. The measure will reduce compliance costs for trustees and will be more effective in attributing trust distributions to beneficiaries than current arrangements.

Operation Wickenby — addressing offshore tax schemes

Expense ($m)

	2006-07	2007-08	2008-09	2009-10
Australian Taxation Office	36.8	36.2	33.9	34.2
Australian Federal Police	16.0	13.3	13.4	13.5
Commonwealth Director of Public Prosecutions	11.4	15.2	16.3	14.0
Australian Crime Commission	3.9	3.2	3.2	3.2
Australian Securities and Investments Commission	2.6	2.6	-	-
Total	70.6	70.5	66.8	64.9
Related revenue ($m)				
Australian Taxation Office	*91.0*	*98.0*	*100.0*	*34.0*
Related capital ($m)				
Australian Taxation Office	*2.1*	*1.1*	-	-
Australian Crime Commission	-	-	-	-
Australian Securities and Investments Commission	-	-	-	-
Australian Federal Police	-	-	-	-
Total	*2.1*	*1.1*	-	-

The Government will provide $305.1 million over seven years (including $22.0 million in 2005-06, $6.0 million in 2010-11, and $1.1 million in 2011-12) for investigations and prosecutions related to Operation Wickenby which addresses alleged tax fraud involving the use of offshore entities.

This measure includes $2.4 million in capital funding in 2005-06 (including $0.1 million for the Australian Taxation Office, $0.6 million for the Australian Crime Commission, $1.3 million for the Australian Federal Police and $0.4 million for the Australian Securities and Investments Commission) for information and communication technology related costs.

This measure is also expected to result in increased tax revenue of $323.0 million over four years from active compliance and through improved compliance behaviour by the relevant taxpayers.

Further information can be found in the press release of 8 February 2006 issued by the Treasurer.