4 Tax reform and other changes

4.1 Introduction

The Australian tax system has undergone substantial reform over the past two years, most significantly as a result of the introduction of *The New Tax System* and *The New Business Tax System*. This chapter provides an outline of the impact of these reforms on tax expenditures, as well as other changes that have occurred since the *1997-98 Tax Expenditures Statement*.

4.2 The effects of tax reform on tax expenditures

Income tax and fringe benefits tax

The new personal income tax scales, introduced from 1 July 2000 as part of *The New Tax System*, affect the costings of some personal income tax expenditures. Changes to the personal income tax scales include:

- an increase in the tax free threshold to $6,000;
- a reduction in the lowest marginal tax rate from 20 per cent to 17 per cent; and
- a reduction in the 34 per cent and 43 per cent marginal tax rates to 30 per cent, and an increase in the range of income over which it applies.

The New Tax System includes significant increases in assistance for families, low-income earners and senior Australians. These changes create new tax expenditures from 2000-01, remove some previous tax expenditures and impact on the costing of some existing tax expenditures.

- The families package simplifies twelve forms of assistance, previously available through the tax and social security systems, into three new family benefit payments. Families have a choice of receiving Family Tax Benefit (FTB), Parts A and B as fortnightly payments or through the tax system (either as reduced tax instalment deductions or as an end of year lump sum). Child Care Benefit is to be paid through direct expenditures.
- Social security and veterans' pensions and allowances, and the income and asset tests for these payments, were increased on 1 July 2000. Accordingly, there is a flow-on to the estimated cost of the Pensioner Rebate, Beneficiary Rebate and Low Income Aged Persons Rebate. In addition, the Pensioner Rebate and Low Income Aged Persons Rebate increased as part of *The New Tax System*.

- Two one-off non-taxable savings bonuses (the Aged Persons Savings Bonus and the Self-Funded Retirees Supplementary Bonus) were also introduced for senior Australians.

Two measures under *The New Tax System* were introduced from 1999-2000:

- the private health insurance rebate for 30 per cent of the cost of private health insurance (introduced on 1 January 1999); and

- a requirement for employers to report the grossed-up taxable value of an employee's fringe benefits on their group certificate where the value of fringe benefits exceeds $1,000. This measure took effect from 1 April 1999. The reporting of fringe benefits enables their value to be taken into account in income tests to determine entitlement to income-tested government benefits, and liability to tax surcharges and income-tested obligations (such as child support payments). As such, any exclusion from the fringe benefits reporting requirement will give rise to a tax expenditure.

The cessation of the Savings Rebate was announced in *A New Tax System*.

Business tax

The Government has announced a broad range of business tax reform measures as part of *The New Business Tax System* since the release of the Ralph Committee report on business taxation, *A Tax System Redesigned*. These measures include a range of entity-related reforms, including:

- the lowering of the company tax rate;

- refundable imputation credits;

- changes to the taxation of life insurers; and

- a range of integrity measures.

With a few exceptions, these changes have generally been incorporated as part of the tax expenditure benchmark and, hence, have not affected the range of tax expenditures identified in this Statement. (The only exception to this is the transitional measures for the taxation of life insurers' management fees.)

A consistent theme underlying the business income tax reforms is achieving a closer alignment between commercial and tax outcomes. Key business tax reforms that have influenced the benchmark for business income are changes to the taxation of capital gains and the tightening of the 13-month rule for prepayments. The removal of accelerated depreciation reinforces the use of an effective life benchmark when evaluating measures affecting the treatment of depreciable assets.

Under *The New Business Tax System*, CGT discounts for individuals and superannuation funds have replaced CGT indexation for all taxpayers and averaging for individuals. The discounts for individuals and superannuation funds are set at different rates while companies are excluded. The differential treatment of these taxpayers highlights the concessional nature of the CGT discounts. Consequently, the capital gains benchmark in this Statement reflects a position of full taxation of capital gains, with the CGT discounts for individuals and superannuation funds being identified as tax expenditures. This differs from the previous approach where indexation and averaging were included as part of the benchmark for capital gains.

Other recently announced CGT measures that result in new tax expenditures under this benchmark include the small business CGT concessions, scrip-for-scrip rollover relief and the venture capital concessions.

The announced tightening of the 13-month rule for prepaid expenditure is consistent with the accounting treatment, which requires apportionment of the expenditure over the period in which the benefits are received. Consistent with this approach, deviations from apportionment have been highlighted as tax expenditures in this Statement. The announced transitional arrangement for the tightening of the 13-month rule, and the continuation of immediate deductibility of short-term prepayments for some taxpayers, are identified as tax expenditures.

4.3 Changes in tax expenditures since 1997-98

A number of new tax expenditures have been introduced, and changes to existing ones have been made, since the *1997-98 Tax Expenditures Statement*, including those mentioned above related to tax reform measures.

New tax expenditures

Tax expenditures arising from measures that have been legislated since the *1997-98 Tax Expenditures Statement* are as follows (tax expenditure reference codes, used in Chapter 5 and Appendix A, are reported in parentheses):

- FTB, Parts A and B, including income tax exemption (A43);
- exemption from income tax of Child Care Benefit (A44);
- exemption from income tax of one-off savings bonus payments made to senior Australians (A45);
- taxation relief for post-judgement awards of interest in personal injury compensation cases (A62);
- small business 15 year retirement CGT exemption (B6);

- exclusions from the fringe benefits reporting requirement under the *Fringe Benefits Tax Regulations 1992* for:
  - certain benefits provided to Australian Defence Force personnel (C3);
  - the element of the Overseas Living Allowance that compensates for the cost of living differences at overseas posts (C4);
  - regional area housing benefits provided by charities, public and non-profit hospitals and police services during the FBT year commencing 1 April 1999 (C17); and
  - travel between home and work in marked emergency vehicles (C52);
- FBT exemption for housing provided by charities, non-profit hospitals and police services in regional areas (C16);
- FBT exemption for free travel by police officers to and from duty on public transport (C21);
- FBT exemption for organisations promoting the prevention or control of disease or illness in people (C53);
- income tax exemption for business grants from the Cyclones Elaine and Vance Trust Fund (D26);
- transitional taxation of life insurance management fees (D27);
- venture capital concessions (D32);
- small business 50 per cent CGT concessions for the sale of active business assets (D33);
- CGT discount for individuals (D38);
- CGT discount for superannuation funds (D39);
- CGT scrip-for-scrip rollover relief (D40);
- CGT rollover relief for involuntary disposals (D41);
- concession for eligible scientific research (D51), which also incorporates the previous deduction for payments to an approved scientific research institute (1997-98 TES reference code GR1);
- depreciation pooling for low-value assets (D64);
- immediate deductibility for GST-related plant and software (D77);

- transitional arrangements for prepayments (D79);
- exemption from the tax shelter prepayments measure for passive investments (D81);
- exemption from non-commercial losses provisions (primary producers and artists) (D83);
- penalty rate of excise levied on cigarettes with less than 0.8 grams of tobacco (E2).
- no excise-free threshold, as applies to beer, for other exciseable alcoholic beverages not exceeding 10 per cent alcohol (E7); and
- wine equalisation tax (WET) rebate for cellar door and mail order wine sales (E8).

Measures that were not previously reported, but which have been recently identified as tax expenditures, are as follows (tax expenditure reference codes are reported in parentheses):

- Medicare levy surcharge (A30);
- accelerated depreciation for employees' amenities (D62);
- accelerated depreciation for software (D75);
- 13-month rule for prepayments (D78);
- the 10-year rule for prepayments (D80);
- capitalisation of non-capital costs of ownership of property (other than main residence) held at least partly for private use (D82);
- concessional rate of excise levied on fuel oil, heating oil and kerosene (E4); and
- concessional rate of excise levied on aviation gasoline and aviation turbine fuel (E5).

Modified tax expenditures

The following tax expenditures have been modified[1] since they were last reported in the *1997-98 Tax Expenditures Statement* (the respective tax expenditure reference codes from this Statement and the *1997-98 Tax Expenditures Statement* are reported in parentheses):

- the estimated cost of the Private Health Insurance Rebate has been split into the actual rebate refunded and the income tax exemption for both the rebate and the corresponding expense (A29; H11);

---

1 Items that have been modified as a result of a change to the applicable tax rate are not listed.

- the Pensioner Rebate has been increased (A33; SS3);

- the Low Income Aged Persons Rebate has been increased (A40; SS28);

- the Sole Parent Rebate (A31; SS1) has been replaced by FTB, Part B from 1 July 2000 (A43; na);

- the rebate for a housekeeper, who cares for a prescribed dependant of the taxpayer, previously included the dependent spouse rebate with child (A34; SS4). The dependent spouse rebate with child has been replaced with FTB, Part B from 1 July 2000 (A43; na);

- the exemption from income tax of certain social security and repatriation payments, which previously included Family Allowance (A38; SS9). Family Allowance has been replaced with FTB, Part A from 1 July 2000 (A43; na);

- Family Tax Assistance, Parts A and B (A41; SS29) have been replaced with FTB, Parts A and B from 1 July 2000 (A43; na), and the tax expenditure has been split into the actual rebate refunded and the income tax exemption for both the rebate and the corresponding expense;

- the tax expenditure relating to deductions for gifts, other than trading stock, to approved donees has been modified to reflect the introduction of a number of measures to encourage philanthropy (A60; NAF11);

- superannuation and funded retirement benefits (B1; SS13) have been modified in the following ways (see Appendix B for further explanation):

  - to exclude non-superannuation expenditures related to ‘other (unfunded) termination payments’, which are now included as a separate tax expenditure (B2; SS13);

  - to include the estimates for the new CGT discount for superannuation funds (D39; na); and

  - to include the expenditures related to the rebate for spouse contributions, which was previously reported separately (B1; SS27);

- the FBT exemption for benefits provided by public and not-for-profit hospitals has been capped at $17,000 of grossed up taxable value per employee, and FBT treatment of private not-for-profit hospitals has been changed from FBT rebatable to FBT exempt (subject to the $17,000 cap) (C7; H6);

- the FBT exemption for benefits provided by public benevolent institutions (other than public and not-for-profit hospitals) has been capped at $30,000 of grossed up taxable value per employee (C12; SS21);

- the FBT exemption for housing provided by employers to their employees in remote areas has been extended to all employers. This tax expenditure includes three measures reported separately in the *1997-98 Tax Expenditures Statement* (C15; AFF15, MM18 and HC5);

- the income tax exemption for religious institutions and the income tax exemption for scientific, public educational and charitable institutions have been amalgamated (D11; NAF5 and SS16);

- the removal of the concessional tax rate for the life insurance business of friendly societies has been deferred to coincide with the reduction in the company tax rate to 30 per cent in the 2001-02 income year (D20; OEA3);

- the CGT exemption for the disposal of assets under the Cultural Bequests Program has been extended to include the new Cultural Gifts Program (D30; CR9);

- the CGT exemption for a taxpayer's main residence has been extended to include two related measures reported separately in the *1997-98 Tax Expenditures Statement*: measures related to the treatment applying after the dwelling ceases to be the main residence; and the disposal of a licence or right to occupy a flat or unit, including in a retirement village (D43; HC2, HC3 and HC4);

- the deduction for payments to an approved scientific research institute has been incorporated into the new concession for eligible scientific research (D51; GR1);

- the measure to combine 18 depreciation rates into seven classes has been incorporated into the measure on accelerated depreciation for plant and equipment, as it formed part of that accelerated depreciation regime (D61; AD7 and AD8);

- accelerated depreciation allowances for plant and equipment ended for individuals and businesses with a turnover of more than $1 million per annum on 21 September 1999 (D61; AD8);

- the exemption from the foreign tax credit system for certain non-portfolio dividends and branch income derived in a listed country has been split into two tax expenditures: 'exemption for branch profits from foreign tax credit system' and 'exemption of non-portfolio dividends from foreign tax credit system' (D98 and D99; FA6); and

- the exemption of most passive and highly mobile active income derived by controlled foreign companies and transferor trusts in listed countries from accrual taxation has been split into two tax expenditures: 'exemption from accrual taxation for controlled foreign companies' and 'exemption from accrual taxation for transferor trusts' (D100 and D101; FA7).

Deleted tax expenditures[2]

A number of tax expenditures identified in the *1997-98 Tax Expenditures Statement* have been deleted (parentheses refer to the tax expenditure reference codes from the *1997-98 Tax Expenditures Statement)*:

- the exemption from income tax for non-resident sports-persons and sporting clubs or associations on income earned in Australia (the removal of this exemption applies to income derived from 1 July 2000) (CR4 and CR5);

- the taxation rebate for expenditure on approved heritage conservation work, which has been replaced with an expense program effective from 1 July 1999 (CR7);

- the FBT undervaluation of the benefit resulting from the alternative of an indexed statutory value that can be used to value remote area accommodation, due to the extension of the FBT exemption for remote area housing from 1 April 2000 (HC6);

- the CGT treatment of demutualised insurance organisations, as this measure provides appropriate tax treatment, rather than providing a concession (OEA10);

- the generic tax framework for the demutualisation of non-insurance organisations, as this measure provides appropriate tax treatment, rather than providing a concession (OEA25);

- the excise-free status of wine, alcoholic cider and a range of other alcoholic drinks except brandy, because the wine equalisation tax (AFF13) has been included in the excise duty benchmark; and

- measures covering depreciation for buildings and structures, as the benchmark for these measures has been modified to effective life depreciation, and the benchmark effective life of these items are currently under review (AD9, AD10, AD11, AD12).

2 Deleted tax expenditures refer to those that were reported in the *1997-98 Tax Expenditures Statement* but are not reported in this Statement. They do not include tax expenditures that have been abolished but are still listed in Table 5.1.